**Hawaiian Electric Company, Inc.** • PO Box 2750 • Honolulu, HI 96840-0001

Dean K. Matsuura
*Manager*
*Regulatory Affairs*

October 28, 2009



The Honorable Chairman and Members
of the Hawaii Public Utilities Commission
Kekuanaoa Building, First Floor
465 South King Street
Honolulu, Hawaii 96813

Dear Commissioners:

Subject: Docket No. 2008-0083 – Hawaiian Electric 2009 Test Year Rate Case
Hawaiian Electric's Responses to Commission Information Requests

Enclosed for filing are Hawaiian Electric Company, Inc.'s ("Hawaiian Electric") responses to the following information requests ("IRs") issued by the Commission to Hawaiian Electric on October 20, 2009: PUC-IR-190 and -191.[1]

The response to PUC-IR-190 contains confidential information that is provided subject to the Protective Order filed on November 21, 2008 in this proceeding.

Very truly yours,

Enclosures

cc: Division of Consumer Advocacy
Michael L. Brosch, Utilitech, Inc.
Joseph A. Herz, Sawvel & Associates, Inc.
Dr. Kay Davoodi, Department of Defense
James N. McCormick, Department of Defense
Theodore E. Vestal, Department of Defense
Ralph Smith, Larkin & Associates

[1] The IRs issued by the Commission on October 20th were numbered as PUC-IR-184 through PUC-IR-189. For reference purposes, Hawaiian Electric has renumbered them as PUC-IR-186 through PUC-IR-191 to follow in sequential order from the IRs previously submitted by the Commission.

PUC-IR-190

What was the total cost to HECO of audits conducted by external parties from May 2008 through April 2009? Please provide documentation of these costs.

HECO Response:

For purposes of responding to this information request, Hawaiian Electric interprets "total cost to HECO of audits conducted by external parties from May 2008 through April 2009," to mean "invoices received" from May 2008 through April 2009 from third parties for "audits" as defined in the Company's response to PUC-IR-191. The total cost to Hawaiian Electric for audits conducted by third- parties from May 2008 through April 2009 is $2,547,215. Attachment 1 to this response is a summary of the total cost by project and consultant. Attachment 2 to this response contains confidential copies of invoices and/or other nonpublic information that, if disclosed, may harm the Company's ability to obtain consulting services from third parties at reasonable prices. Due to the sensitive nature of the information contained in these documents, Attachment 2 is being submitted pursuant to the Protective Order in this docket.

| | Costs Incurred May'08 - Apr '09 | PROJECT |
|---|---|---|
| KMH | $ 38,115.00 | Annual Risk Assessment & Audit Plan (co-source as described in response to PUC-IR-191) |
| | 16,017.00 | Internal Audit Framework (co-source as described in response to PUC-IR-191) |
| | 80,736.00 | Workforce Development & Succession Planning (co-source as described in response to PUC-IR-191) |
| | 141,816.00 | Materials Management & Procurement (report not issued) (co-source as described in response to PUC-IR-191) |
| | 29,850.00 | Managing Major Customer Accounts (co-source as described in response to PUC-IR-191) |
| | 1,674.00 | Review of Partnership Agreement Process (report not issued) (co-source as described in response to PUC-IR-191) |
| | 77,557.00 | IT General Controls SCADA System (co-source as described in response to PUC-IR-191) |
| | 82,103.00 | IT SOX Assistance (did not result in the issuance of a report) (co-source as described in response to PUC-IR-191) |
| | 38,296.00 | Functional Administration (not allocated to any specific project) (co-source as described in response to PUC-IR-191) |
| | $ 506,164.00 | |
| PWC | $ 56,738.81 | IT Strategy, Governance & Project Review |
| | 178,580.38 | SOX Optimization Project (co-source as described in response to PUC-IR-191) |
| | $ 235,319.19 | |
| Black & Veatch | $ 651,750.83 | Operational Audit (Outage & Maintenance Review) |
| Ward Research | $ 5,445.02 | 2008 Residential Customer Energy Awareness Program Evaluation |
| Market Development G | $ 28,147.75 | Process Evaluation Report for SolarSaver Pilot Program, November 26, 2008 |
| KEMA | $ 269,788.00 | Energy and Peak Demand Impact Evaluation Report of the 2005-2009 Demand Side Management Programs, December 2008 |
| EPRI | $ 25,000.00 | Lightning Performance Analysis Kahe-Waiau 138kV Line Report |
| Power Engineers | $ 75,863.03 | 2008 HECO Outage Investigation |
| KPMG | $ 749,737.91 | External Financial Auditor Fees |
| TOTAL | $ 2,547,215.73 | |

**Confidential Information Deleted Pursuant To Protective Order, Filed on November 21, 2008.**

PUC-IR-190
DOCKET NO. 2008-0083
ATTACHMENT 2

Attachments 2 contains confidential information and is provided subject to the Protective Order filed on November 21, 2008 in this proceeding.

PUC-IR-191

Please provide copies of all reports from audits carried out for the HECO Companies by third parties from 2007 through the present.

HECO Response:

For purposes of responding to this information request, Hawaiian Electric interprets "audits" to include "management audits," as previously described by the Company in its response to PUC-IR-171, financial audits, and co-sourced arrangements by the Corporate Audit Department.

As to financial audits, submitted as Attachment 1 to this response is the Report of Independent Registered Public Accounting Firm and the accompanying consolidated financial statements of Hawaiian Electric Company, Inc. and subsidiaries as of December 31, 2007 and 2006 and for the years ended December 31, 2007, 2006, and 2005 and Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting. Attachment 2 to this response is the Report of Independent Registered Public Accounting Firm and the accompanying consolidated financial statements of Hawaiian Electric Company, Inc. and subsidiaries as of December 31, 2008 and 2007 and for the years ended December 31, 2008, 2007, and 2006 and Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting. In addition, reports by KPMG, the Company's external auditor, are included in the Hawaiian Electric's Securities and Exchange Commission (SEC) Form 10-K filings. See Hawaiian Electric's SEC Form 10-K filed with the Commission on March 4, 2008 and March 3, 2009.

As to management audits, in response to PUC-IR-171, the Company provided copies of third-party reports and objected, but without waiving its objection provided copies of two presentations that were made under the auspices of Hawaiian Electric's Corporate Audit Department. See the Company's response, attachments, and related objection to PUC-IR-171.

As to co-sourced arrangements, these arrangements occur when third-party consultants are co-sourced under the control and direction of the Corporate Audit Department. Under the co-sourced arrangement, the findings, recommendations and the final report, if any, are those of the Corporate Audit Department and are treated no different than those conducted solely by the Corporate Audit Department.

In response to PUC-IR-190 the Company identified projects where third-party consultants were co-sourced for the period from May 2008 to April 2009. See Attachment 1 to the Company's response to PUC-IR-190. From January 2007 through April 2008, there were no projects that were co-sourced. In addition to the co-sourced projects identified in response to PUC-IR-190, the Company identifies the following co-sourced projects which were completed after April 2009:

1. Safeguarding of Customer Information Review – co-sourced arrangement with Deloitte and Touche; and
2. Operational Review for Managing Major Customer Accounts – co-sourced arrangement with KMH.

With respect to Hawaiian Electric's audits that are co-sourced by its internal Corporate Audit Department, Hawaiian Electric objects to disclosing documents that reveal internal analyses, appraisals and recommendations regarding the adequacy and effectiveness of the organization's system of internal controls, risk management practices, and corporate governance. Requiring that this information be subject to review by parties in a regulatory proceeding would have a "chilling" effect on the self-analysis process. Further subjecting such sensitive internal deliberations to review in a regulatory proceeding would inhibit robust and candid internal dialogue of this nature in the future.

General rate proceedings need to balance the need for such information against Hawaiian Electric's need to manage. By analogy, for example, the Federal Freedom of Information Act, codified at 5 U.S.C. § 552, and the Uniform Information Practices Act (Modified), Chapter 92F of the Hawaii Revised Statutes, contain broad disclosure requirements based on the public's interest in open government. However, the broad policy in favor of disclosure still allows for exceptions that are intended to permit the efficient and effective functioning of government by protecting the internal deliberative process. See generally Pennsylvania Public Utility Commission v. West Penn Power Company, 73 PA PUC 122 (July 20, 1990), West Law Slip Op ("deliberative process privilege" recognized by the Pennsylvania Public Utility Commission with respect to its own internal staff reports).

# Hawaiian Electric Company, Inc. and Subsidiaries

## Consolidated Financial Statements as of December 31, 2007 and 2006 and for the years ended December 31, 2007, 2006 and 2005 and Consolidating Schedules as of and for the year ended December 31, 2007

(With Report of Independent Registered Public Accounting Firm Thereon and Annual Report of Management on Internal Control Over Financial Reporting and Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting)

## *Annual Report of Management on Internal Control Over Financial Reporting*

The Board of Directors and Shareholder
Hawaiian Electric Company, Inc.:

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934, as amended. The Company's internal control system was designed to provide reasonable assurance to management and the Board of Directors regarding the preparation and fair presentation of its consolidated financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2007 based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2007.

KPMG LLP, an independent registered public accounting firm, has issued an audit report on the Company's internal control over financial reporting as of December 31, 2007. This report appears on page 2.

/s/ T. Michael May
T. Michael May
President and
Chief Executive Officer

/s/ Tayne S. Y. Sekimura
Tayne S. Y. Sekimura
Senior Vice President,
Finance & Administration
and Chief Financial Officer

/s/ Patsy H. Nanbu
Patsy H. Nanbu
Controller and
Chief Accounting Officer

February 21, 2008

KPMG

KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

## Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

The Board of Directors and Shareholder
Hawaiian Electric Company, Inc.:

We have audited Hawaiian Electric Company, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Hawaiian Electric Company, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying annual report of management on internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Hawaiian Electric Company, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets and statements of capitalization of Hawaiian Electric Company, Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in common stock equity, and cash flows for each of the years in the three-year period ended December 31, 2007, and our report dated February 21, 2008 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Honolulu, Hawaii
February 21, 2008

KPMG

KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholder
Hawaiian Electric Company, Inc.:

We have audited the accompanying consolidated balance sheets and consolidated statements of capitalization of Hawaiian Electric Company, Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in common stock equity, and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hawaiian Electric Company, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Notes 1 and 7 to the consolidated financial statements, the Company changed its method of accounting for income taxes in 2007.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated statements rather than to present the financial position, results of operations and cash flows of the individual companies. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Hawaiian Electric Company, Inc.'s internal control over financial reporting as of December31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 21, 2008 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

KPMG LLP

Honolulu, Hawaii
February 21, 2008

## Consolidated Financial Statements

### Consolidated Statements of Income

**Hawaiian Electric Company, Inc. and Subsidiaries**

| Years ended December 31 | 2007 | 2006 | 2005 |
|---|---|---|---|
| (in thousands) | | | |
| Operating revenues | $2,096,958 | $2,050,412 | $1,801,710 |
| **Operating expenses** | | | |
| Fuel oil | 774,119 | 781,740 | 639,650 |
| Purchased power | 536,960 | 506,893 | 458,120 |
| Other operation | 214,047 | 186,449 | 172,962 |
| Maintenance | 105,743 | 90,217 | 82,242 |
| Depreciation | 137,081 | 130,164 | 122,870 |
| Taxes, other than income taxes | 194,607 | 190,413 | 167,295 |
| Income taxes | 34,126 | 47,381 | 45,029 |
| | 1,996,683 | 1,933,257 | 1,688,168 |
| **Operating income** | 100,275 | 117,155 | 113,542 |
| **Other income** | | | |
| Allowance for equity funds used during construction | 5,219 | 6,348 | 5,105 |
| Other, net | (627) | 3,123 | 3,538 |
| | 4,592 | 9,471 | 8,643 |
| **Income before interest and other charges** | 104,867 | 126,626 | 122,185 |
| **Interest and other charges** | | | |
| Interest on long-term debt | 45,964 | 43,109 | 43,063 |
| Amortization of net bond premium and expense | 2,440 | 2,198 | 2,212 |
| Other interest charges | 4,864 | 7,256 | 4,133 |
| Allowance for borrowed funds used during construction | (2,552) | (2,879) | (2,020) |
| Preferred stock dividends of subsidiaries | 915 | 915 | 915 |
| | 51,631 | 50,599 | 48,303 |
| **Income before preferred stock dividends of HECO** | 53,236 | 76,027 | 73,882 |
| Preferred stock dividends of HECO | 1,080 | 1,080 | 1,080 |
| Net income for common stock | $ 52,156 | $ 74,947 | $ 72,802 |

### Consolidated Statements of Retained Earnings

**Hawaiian Electric Company, Inc. and Subsidiaries**

| Years ended December 31 | 2007 | 2006 | 2005 |
|---|---|---|---|
| (in thousands) | | | |
| **Retained earnings, January 1** | $700,252 | $654,686 | $632,779 |
| Net income for common stock | 52,156 | 74,947 | 72,802 |
| Adjustment to initially apply FIN 48 | (620) | - | - |
| Common stock dividends | (27,084) | (29,381) | (50,895) |
| **Retained earnings, December 31** | $724,704 | $700,252 | $654,686 |

See accompanying "Notes to Consolidated Financial Statements."

## Consolidated Balance Sheets

### Hawaiian Electric Company, Inc. and Subsidiaries

| December 31<br>(in thousands) | 2007 | 2006 |
|---|---|---|
| **Assets** | | |
| **Utility plant, at cost** | | |
| Land | $ 38,161 | $ 35,242 |
| Plant and equipment | 4,131,226 | 4,002,929 |
| Less accumulated depreciation | (1,647,113) | (1,558,913) |
| Plant acquisition adjustment, net | 41 | 93 |
| Construction in progress | 151,179 | 95,619 |
| **Net utility plant** | 2,673,494 | 2,574,970 |
| **Current assets** | | |
| Cash and equivalents | 4,678 | 3,859 |
| Customer accounts receivable, net | 146,112 | 125,524 |
| Accrued unbilled revenues, net | 114,274 | 92,195 |
| Other accounts receivable, net | 6,915 | 4,423 |
| Fuel oil stock, at average cost | 91,871 | 64,312 |
| Materials and supplies, at average cost | 34,258 | 30,540 |
| Prepayments and other | 9,490 | 9,695 |
| **Total current assets** | 407,598 | 330,548 |
| **Other long-term assets** | | |
| Regulatory assets | 284,990 | 112,349 |
| Unamortized debt expense | 15,635 | 13,722 |
| Other | 42,171 | 31,545 |
| **Total other long-term assets** | 342,796 | 157,616 |
| | $3,423,888 | $3,063,134 |
| **Capitalization and liabilities** | | |
| **Capitalization** *(see Consolidated Statements of Capitalization)* | | |
| Common stock equity | $ 1,110,462 | $ 958,203 |
| Cumulative preferred stock, not subject to mandatory redemption | 34,293 | 34,293 |
| Long-term debt, net | 885,099 | 766,185 |
| **Total capitalization** | 2,029,854 | 1,758,681 |
| **Current liabilities** | | |
| Short-term borrowings-nonaffiliates | 28,791 | 113,107 |
| Accounts payable | 137,895 | 102,512 |
| Interest and preferred dividends payable | 14,719 | 10,645 |
| Taxes accrued | 189,637 | 152,182 |
| Other | 57,799 | 43,120 |
| **Total current liabilities** | 428,841 | 421,566 |
| **Deferred credits and other liabilities** | | |
| Deferred income taxes | 162,113 | 118,055 |
| Regulatory liabilities | 261,606 | 240,619 |
| Unamortized tax credits | 58,419 | 57,879 |
| Other | 183,318 | 189,606 |
| **Total deferred credits and other liabilities** | 665,456 | 606,159 |
| **Contributions in aid of construction** | 299,737 | 276,728 |
| | $3,423,888 | $3,063,134 |

See accompanying "Notes to Consolidated Financial Statements."

## Consolidated Statements of Capitalization

**Hawaiian Electric Company, Inc. and Subsidiaries**

| December 31 | 2007 | 2006 | 2005 |
|---|---|---|---|
| (dollars in thousands, except par value) | | | |
| **Common stock equity** | | | |
| Common stock of $6 2/3 par value | | | |
| Authorized: 50,000,000 shares. Outstanding: | | | |
| 2007, 2006 and 2005, 12,805,843 shares | $ 85,387 | $ 85,387 | $ 85,387 |
| Premium on capital stock | 299,214 | 299,214 | 299,212 |
| Retained earnings | 724,704 | 700,252 | 654,686 |
| Accumulated other comprehensive income (loss), net of income tax benefits: | | | |
| Retirement benefit plans | 1,157 | (126,650) | (26) |
| **Common stock equity** | 1,110,462 | 958,203 | $1,039,259 |

**Cumulative preferred stock**
**not subject to mandatory redemption**
Authorized: 5,000,000 shares of $20 par value and 7,000,000 shares of $100 par value.
Outstanding: 2007 and 2006, 1,234,657 shares.

| Series | Par Value | | Shares Outstanding December 31, 2007 and 2006 | 2007 | 2006 |
|---|---|---|---|---|---|
| (dollars in thousands, except par value and shares outstanding) | | | | | |
| C-4 1/4% | $ 20 | (HECO) | 150,000 | 3,000 | 3,000 |
| D-5% | 20 | (HECO) | 50,000 | 1,000 | 1,000 |
| E-5% | 20 | (HECO) | 150,000 | 3,000 | 3,000 |
| H-5 1/4% | 20 | (HECO) | 250,000 | 5,000 | 5,000 |
| I-5% | 20 | (HECO) | 89,657 | 1,793 | 1,793 |
| J-4 3/4% | 20 | (HECO) | 250,000 | 5,000 | 5,000 |
| K-4.65% | 20 | (HECO) | 175,000 | 3,500 | 3,500 |
| G-7 5/8% | 100 | (HELCO) | 70,000 | 7,000 | 7,000 |
| H-7 5/8% | 100 | (MECO) | 50,000 | 5,000 | 5,000 |
| | | | 1,234,657 | $ 34,293 | $ 34,293 |

(continued)

See accompanying "Notes to Consolidated Financial Statements."

## Consolidated Statements of Capitalization, *continued*

## Hawaiian Electric Company, Inc. and Subsidiaries

| December 31<br>(in thousands) | 2007 | 2006 |
|---|---|---|
| **Long-term debt** | | |
| Obligations to the State of Hawaii for the repayment of Special Purpose Revenue Bonds: | | |
| HECO, 4.60%, refunding series 2007B, due 2026 | $ 62,000 | $ - |
| HELCO, 4.60%, refunding series 2007B, due 2026 | 8,000 | – |
| MECO, 4.60%, refunding series 2007B, due 2026 | 55,000 | – |
| HECO, 4.65%, series 2007A, due 2037 | 100,000 | – |
| HELCO, 4.65%, series 2007A, due 2037 | 20,000 | – |
| MECO, 4.65%, series 2007A, due 2037 | 20,000 | – |
| HECO, 4.80%, refunding series 2005A, due 2025 | 40,000 | 40,000 |
| HELCO, 4.80%, refunding series 2005A, due 2025 | 5,000 | 5,000 |
| MECO, 4.80%, refunding series 2005A, due 2025 | 2,000 | 2,000 |
| HECO, 5.00%, refunding series 2003B, due 2022 | 40,000 | 40,000 |
| HELCO, 5.00%, refunding series 2003B, due 2022 | 12,000 | 12,000 |
| HELCO, 4.75%, refunding series 2003A, due 2020 | 14,000 | 14,000 |
| HECO, 5.10%, series 2002A, due 2032 | 40,000 | 40,000 |
| HECO, 5.70%, refunding series 2000, due 2020 | 46,000 | 46,000 |
| MECO, 5.70%, refunding series 2000, due 2020 | 20,000 | 20,000 |
| HECO, 6.15%, refunding series 1999D, due 2020 | 16,000 | 16,000 |
| HELCO, 6.15%, refunding series 1999D, due 2020 | 3,000 | 3,000 |
| MECO, 6.15%, refunding series 1999D, due 2020 | 1,000 | 1,000 |
| HECO, 6.20%, series 1999C, due 2029 | 35,000 | 35,000 |
| HECO, 5.75%, refunding series 1999B, due 2018 | 30,000 | 30,000 |
| HELCO, 5.75%, refunding series 1999B, due 2018 | 11,000 | 11,000 |
| MECO, 5.75%, refunding series 1999B, due 2018 | 9,000 | 9,000 |
| HELCO, 5.50%, refunding series 1999A, due 2014 | 11,400 | 11,400 |
| HECO, 4.95%, refunding series 1998A, due 2012 | 42,580 | 42,580 |
| HELCO, 4.95%, refunding series 1998A, due 2012 | 7,200 | 7,200 |
| MECO, 4.95%, refunding series 1998A, due 2012 | 7,720 | 7,720 |
| HECO, 5.65%, series 1997A, due 2027 | 50,000 | 50,000 |
| HELCO, 5.65%, series 1997A, due 2027 | 30,000 | 30,000 |
| MECO, 5.65%, series 1997A, due 2027 | 20,000 | 20,000 |
| HECO, 5 7/8%, series 1996B, refunded in 2007 | – | 14,000 |
| HELCO, 5 7/8%, series 1996B, refunded in 2007 | – | 1,000 |
| MECO, 5 7/8%, series 1996B, refunded in 2007 | – | 35,000 |
| HECO, 6.20%, series 1996A, refunded in 2007 | – | 48,000 |
| HELCO, 6.20%, series 1996A, refunded in 2007 | – | 7,000 |
| MECO, 6.20%, series 1996A, refunded in 2007 | – | 20,000 |
| HECO, 5.45%, series 1993, due 2023 | 50,000 | 50,000 |
| HELCO, 5.45%, series 1993, due 2023 | 20,000 | 20,000 |
| MECO, 5.45%, series 1993, due 2023 | 30,000 | 30,000 |
| | 857,900 | 717,900 |
| Less funds on deposit with trustee | 22,461 | – |
| *Total obligations to the State of Hawaii* | 835,439 | 717,900 |
| Other long-term debt – unsecured: | | |
| 6.50 %, series 2004, Junior subordinated deferrable interest debentures, due 2034 | 51,546 | 51,546 |
| Total long-term debt | 886,985 | 769,446 |
| Less unamortized discount | 1,886 | 3,261 |
| **Long-term debt, net** | 885,099 | 766,185 |
| ***Total capitalization*** | $2,029,854 | $1,758,681 |

See accompanying "Notes to Consolidated Financial Statements."

**Consolidated Statements of Changes in Common Stock Equity**

**Hawaiian Electric Company, Inc. and Subsidiaries**

| (in thousands) | Common stock Shares | Common stock Amount | Premium on capital stock | Retained earnings | Accumulated other comprehensive income (loss) | Total |
|---|---|---|---|---|---|---|
| **Balance, December 31, 2004** | **12,806** | **$85,387** | **$299,213** | **$632,779** | **$ (275)** | **$1,017,104** |
| Comprehensive income: | | | | | | |
| *Net income* | – | – | – | 72,802 | – | 72,802 |
| Minimum pension liability adjustment, net of taxes of $158 | – | – | – | – | 249 | 249 |
| Comprehensive income | – | – | – | 72,802 | 249 | 73,051 |
| Common stock dividends | – | – | – | (50,895) | – | (50,895) |
| Other | – | – | (1) | – | – | (1) |
| **Balance, December 31, 2005** | **12,806** | **85,387** | **299,212** | **654,686** | **(26)** | **1,039,259** |
| Comprehensive income: | | | | | | |
| Net income | – | – | – | 74,947 | – | 74,947 |
| Minimum pension liability adjustment, net of taxes of $18 | – | – | – | – | 26 | 26 |
| Comprehensive income | – | – | – | 74,947 | 26 | 74,973 |
| Adjustment to initially apply SFAS No. 158, net of tax benefits of $80,666 | – | – | – | – | (126,650) | (126,650) |
| Common stock dividends | – | – | – | (29,381) | – | (29,381) |
| Other | – | – | 2 | – | – | 2 |
| **Balance, December 31, 2006** | **12,806** | **85,387** | **299,214** | **700,252** | **(126,650)** | **958,203** |
| Comprehensive income: | | | | | | |
| Net income | – | – | – | 52,156 | – | 52,156 |
| Retirement benefit plans: | | | | | | |
| Net gains arising during the period, net of taxes of $9,861 | – | – | – | – | 15,484 | 15,484 |
| Less: amortization of transition obligation, prior service credit and net losses recognized during the period in net periodic benefit cost, net of tax benefits of $5,001 | – | – | – | – | 7,854 | 7,854 |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory asset, net of taxes of $11,007 | – | – | – | – | (17,282) | (17,282) |
| Comprehensive income | – | – | – | 52,156 | 6,056 | 58,212 |
| Adjustment to initially apply a PUC interim D&O related to defined benefit retirement plans, net of taxes of $77,546 | – | – | – | – | 121,751 | 121,751 |
| Adjustment to initially apply FIN 48 | – | – | – | (620) | – | (620) |
| Common stock dividends | – | – | – | (27,084) | – | (27,084) |
| **Balance, December 31, 2007** | **12,806** | **$85,387** | **$299,214** | **$724,704** | **$ 1,157** | **$1,110,462** |

**Consolidated Statements of Cash Flows**

**Hawaiian Electric Company, Inc. and Subsidiaries**

| Years ended December 31<br>(in thousands) | 2007 | 2006 | 2005 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Income before preferred stock dividends of HECO | $ 53,236 | $ 76,027 | $ 73,882 |
| Adjustments to reconcile income before preferred stock dividends of HECO to net cash provided by operating activities: | | | |
| Depreciation of utility plant | 137,081 | 130,164 | 122,870 |
| Other amortization | 8,230 | 7,932 | 8,479 |
| Writedown of utility plant | 11,701 | -- | -- |
| Deferred income taxes | (31,888) | (9,671) | 19,086 |
| Tax credits, net | 1,992 | 3,810 | 3,471 |
| Allowance for equity funds used during construction | (5,219) | (6,348) | (5,105) |
| Changes in assets and liabilities: | | | |
| Decrease (increase) in accounts receivable | (23,080) | 8,709 | (30,150) |
| Increase in accrued unbilled revenues | (22,079) | (874) | (12,293) |
| Decrease (increase) in fuel oil stock | (27,559) | 21,138 | (26,880) |
| Increase in materials and supplies | (3,718) | (3,566) | (3,206) |
| Increase in regulatory assets | (1,968) | (6,123) | (5,036) |
| Increase (decrease) in accounts payable | 35,383 | (19,689) | 28,186 |
| Increase in taxes accrued | 37,455 | 18,599 | 27,658 |
| Decrease (increase) in prepaid pension benefit cost | -- | 20,064 | (300) |
| Other | 16,108 | (12,641) | (15,944) |
| **Net cash provided by operating activities** | 185,675 | 227,531 | 184,718 |
| **Cash flows from investing activities** | | | |
| Capital expenditures | (209,821) | (195,072) | (217,610) |
| Contributions in aid of construction | 19,011 | 19,707 | 21,083 |
| Proceeds from sales of assets | 5,440 | 407 | 1,680 |
| **Net cash used in investing activities** | (185,370) | (174,958) | (194,847) |
| **Cash flows from financing activities** | | | |
| Common stock dividends | (27,084) | (29,381) | (50,895) |
| Preferred stock dividends | (1,080) | (1,080) | (1,080) |
| Proceeds from issuance of long-term debt | 242,538 | -- | 59,462 |
| Repayment of long-term debt | (126,000) | -- | (47,000) |
| Net increase (decrease) in short-term borrowings from nonaffiliates and affiliate with original maturities of three months or less | (84,316) | (23,058) | 47,597 |
| Other | (3,544) | 4,662 | 1,861 |
| **Net cash provided by (used in) financing activities** | 514 | (48,857) | 9,945 |
| Net increase (decrease) in cash and equivalents | 819 | 3,716 | (184) |
| **Cash and equivalents, January 1** | 3,859 | 143 | 327 |
| **Cash and equivalents, December 31** | $ 4,678 | $ 3,859 | $ 143 |

See accompanying "Notes to Consolidated Financial Statements."

## Notes to Consolidated Financial Statements

## Hawaiian Electric Company, Inc. and Subsidiaries

### 1. Summary of significant accounting policies

**General**

Hawaiian Electric Company, Inc. (HECO) and its wholly-owned operating subsidiaries, Hawaii Electric Light Company, Inc. (HELCO) and Maui Electric Company, Limited (MECO), are electric public utilities in the business of generating, purchasing, transmitting, distributing and selling electric energy on all major islands in Hawaii other than Kauai, and are regulated by the Public Utilities Commission of the State of Hawaii (PUC). HECO also owns non-regulated subsidiaries: Renewable Hawaii, Inc. (RHI), which will invest in renewable energy projects, Uluwehiokama Biofuels Corp. (UBC), which will partly own a new biodiesel refining plant to be built on the island of Maui by 2009 and will direct its profits into a trust to be created for the purpose of funding biofuels development in Hawaii, and HECO Capital Trust III, which is an unconsolidated financing entity.

**Basis of presentation**

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change include the amounts reported for property, plant and equipment; pension and other postretirement benefit obligations; contingencies and litigation; income taxes; regulatory assets and liabilities; revenues; and variable interest entities (VIEs).

**Consolidation**

The consolidated financial statements include the accounts of HECO and its subsidiaries (collectively, the Company), but exclude subsidiaries which are variable-interest entities of which the Company is not the primary beneficiary. Investments in companies over which the Company has the ability to exercise significant influence, but not control, are accounted for using the equity method. The Company is a wholly-owned subsidiary of Hawaiian Electric Industries, Inc. (HEI). All material intercompany accounts and transactions have been eliminated in consolidation.

See Note 3 for information regarding the application of Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46(R).

**Regulation by the Public Utilities Commission of the State of Hawaii (PUC)**

HECO, HELCO and MECO are regulated by the PUC and account for the effects of regulation under Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." As a result, the actions of regulators can affect the timing of recognition of revenues, expenses, assets and liabilities. Management believes its operations currently satisfy the SFAS No. 71 criteria. If events or circumstances should change so that those criteria are no longer satisfied, the Company expects that the regulatory assets would be charged to expense and the regulatory liabilities would be credited to income or refunded to ratepayers. In the event of unforeseen regulatory actions or other circumstances, however, management believes that a material adverse effect on the Company's results of operations and financial position may result if regulatory assets have to be charged to expense without an offsetting credit for regulatory liabilities or if regulatory liabilities are required to be refunded to ratepayers.

**Equity method**

Investments in up to 50%-owned affiliates over which the Company has the ability to exercise significant influence over the operating and financing policies and investments in unconsolidated subsidiaries (e.g. HECO Capital Trust III) are accounted for under the equity method, whereby the investment is carried at cost, plus (or minus) the Company's equity in undistributed earnings (or losses) and minus distributions since acquisition. Equity in earnings or losses is reflected in other income. Equity method investments are evaluated for other-than-temporary impairment.

**Utility plant**

Utility plant is reported at cost. Self-constructed plant includes engineering, supervision, administrative and general costs and an allowance for the cost of funds used during the construction period. These costs are recorded in construction in progress and are transferred to utility plant when construction is completed and the facilities are either placed in service or become useful for public utility purposes. Costs for betterments that make utility plant more useful, more efficient, of greater durability or of greater capacity are also capitalized. Upon the retirement or sale of electric utility plant, generally no gain or loss is recognized. The cost of the plant retired is charged to accumulated depreciation. Amounts collected from customers for cost of removal (expected to exceed salvage value in the future) are included in regulatory liabilities.

If a power purchase agreement (PPA) falls within the scope of Emerging Issues Task Force (EITF) Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease" and results in the classification of the agreement as a capital lease, the Company would recognize a capital asset and a lease obligation.

**Depreciation**

Depreciation is computed primarily using the straight-line method over the estimated lives of the assets being depreciated. Utility plant additions in the current year are depreciated beginning January 1 of the following year. Utility plant has lives ranging from 20 to 45 years for production plant, from 25 to 60 years for transmission and distribution plant and from 7 to 45 years for general plant. The composite annual depreciation rate, which includes a component for cost of removal, was 3.8% in 2007 and 3.9% in 2006 and 2005.

**Cash and equivalents**

The Company considers cash on hand, deposits in banks, money market accounts, certificates of deposit, short-term commercial paper and liquid investments (with original maturities of three months or less) to be cash and equivalents.

**Accounts receivable**

Accounts receivable are recorded at the invoiced amount. The Company generally assesses a late payment charge on balances unpaid from the previous month. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company adjusts its allowance on a monthly basis, based on its historical write-off experience. Account balances are charged off against the allowance after collection efforts have been exhausted and the potential for recovery is considered remote.

**Retirement benefits**

Pension and other postretirement benefit costs are charged primarily to expense and electric utility plant. Funding for the Company's qualified pension plans is based on actuarial assumptions adopted by the Pension Investment Committee administering the Plans on the advice of an enrolled actuary. The participating employers contribute amounts to a master pension trust for the Plans in accordance with the funding requirements of Employee Retirement Income Security Act of 1974, as amended (ERISA), including changes promulgated by the Pension Protection Act, and considering the deductibility of contributions under the Internal Revenue Code. The Company generally funds at least the net periodic pension cost as calculated using SFAS No. 87 "Employers' Accounting for Pensions" during the fiscal year, subject to limits and targeted funded status as determined with the consulting actuary. Under pension tracking mechanisms approved by the PUC on an interim basis, HECO and MECO generally will make contributions to the pension fund at the minimum level required under the law, until the pension assets (existing at the time of the PUC decisions and determined based on the cumulative fund contributions in excess of the cumulative net periodic pension cost recognized) are reduced to zero, at which time HECO and MECO would fund the pension cost as specified in the pension tracking mechanism. HELCO will generally fund the net periodic pension cost. Future decisions in rate cases could further impact funding amounts.

Certain health care and/or life insurance benefits are provided to eligible retired employees and the employees' beneficiaries and covered dependents. The Company generally funds the net periodic postretirement benefit costs other than pensions as calculated using SFAS No. 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions" and the amortization of the regulatory asset for postretirement benefits other than pensions (OPEB), while maximizing the use of the most tax advantaged funding vehicles, subject to cash flow requirements and reviews of the funded status with the consulting actuary. The Company must fund OPEB costs as specified in the OPEB tracking mechanisms, which were approved by the PUC on an interim basis. Future decisions in rate cases could further impact funding amounts.

Effective December 31, 2006, the Company adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)," and recognized on its balance sheet the funded status of its defined benefit pension and other postretirement benefit plans, as adjusted by the impact of decisions of the PUC.

**Financing costs**

The Company uses the straight-line method to amortize financing costs and premiums or discounts over the term of the related long-term debt. Unamortized financing costs and discounts or premiums on long-term debt retired prior to maturity are classified as regulatory assets (costs and premiums) or liabilities (discounts) and are amortized on a straight-line basis over the remaining original term of the retired debt. The method and periods for amortizing financing costs, premiums and discounts, including the treatment of these items when long-term debt is retired prior to maturity, have been established by the PUC as part of the rate-making process.

The Company uses the straight-line method to amortize the fees and related costs paid to secure a firm commitment under its line-of-credit arrangements.

**Contributions in aid of construction**

The Company receives contributions from customers for special construction requirements. As directed by the PUC, contributions are amortized on a straight-line basis over 30 years as an offset against depreciation expense.

**Electric utility revenues**

Electric utility revenues are based on rates authorized by the PUC and include revenues applicable to energy consumed in the accounting period but not yet billed to the customers. Revenues related to the sale of energy are generally recorded when service is rendered or energy is delivered to customers. However, the determination of the energy sales to individual customers for billing purposes is based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each month, amounts of energy delivered to customers since the date of the last meter reading are estimated and the corresponding unbilled revenue is estimated. This unbilled revenue is estimated each month based on the meter readings in the beginning of the following month, monthly generation volumes, estimated customer usage by account, line losses and applicable customer rates based on historical values and current rate schedules. As of December 31, 2007, customer accounts receivable include unbilled energy revenues of $114 million on a base of annual revenue of $2.1 billion. Revenue amounts recorded pursuant to a PUC interim order are subject to refund, with interest, pending a final order.

The rate schedules of the Company include energy cost adjustment clauses (ECACs) under which electric rates are adjusted for changes in the weighted-average price paid for fuel oil and certain components of purchased power, and the relative amounts of company-generated power and purchased power. The ECACs also include a provision requiring a quarterly reconciliation of the amounts collected through the ECACs. See "Energy cost adjustment clauses" in Note 11 for a discussion of the ECACs and Act 162 of the 2006 Hawaii State Legislature.

The Company's operating revenues include amounts for various revenue taxes. Revenue taxes are generally recorded as an expense in the year the related revenues are recognized. The Company's payments to the taxing authorities are based on the prior years' revenues. For 2007, 2006 and 2005, the Company included approximately $185 million, $182 million and $159 million, respectively, of revenue taxes in "operating revenues" and in "taxes, other than income taxes" expense.

**Repairs and maintenance costs**

Repairs and maintenance costs for overhauls of generating units are generally expensed as they are incurred.

**Allowance for Funds Used During Construction (AFUDC)**

AFUDC is an accounting practice whereby the costs of debt and equity funds used to finance plant construction are credited on the statement of income and charged to construction in progress on the balance sheet. If a project under construction is delayed for an extended period of time, as it was in the case of HELCO's installation of CT-4 and CT-5, AFUDC on the delayed project may be stopped.

The weighted-average AFUDC rate was 8.1% in 2007, 8.4% in 2006 and 8.5% in 2005, and reflected quarterly compounding.

**Environmental expenditures**

The Company is subject to numerous federal and state environmental statutes and regulations. In general, environmental contamination treatment costs are charged to expense, unless it is probable that the PUC would allow such costs to be recovered in future rates, in which case such costs would be capitalized as regulatory assets. Also, environmental costs are capitalized if the costs extend the life, increase the capacity, or improve the safety or efficiency of property; the costs mitigate or prevent future environmental contamination; or the costs are incurred in preparing the property for sale. Environmental costs are either capitalized or charged to expense when environmental assessments and/or remedial efforts are probable and the cost can be reasonably estimated.

**Income taxes**

The Company is included in the consolidated income tax returns of HECO's parent, HEI. Income tax expense has been computed for financial statement purposes as if HECO and its subsidiaries filed separate consolidated HECO income tax returns.

Deferred income tax assets and liabilities are established for the temporary differences between the financial reporting bases and the tax bases of the Company's assets and liabilities at enacted tax rates expected to be in effect when such deferred tax assets or liabilities are realized or settled. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

Federal and state investment tax credits are deferred and amortized over the estimated useful lives of the properties which qualified for the credits.

Governmental tax authorities could challenge a tax return position taken by management. If the Company's position does not prevail, the Company's results of operations and financial condition may be adversely affected as the related deferred or current income tax asset might be impaired and written down or written off.

Effective January 1, 2007, the Company adopted FIN No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109," and uses a "more-likely-than-not" recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

**Impairment of long-lived assets and long-lived assets to be disposed of**

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

**Recent accounting pronouncements and interpretations**

**Fair value measurements.** In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 applies to fair value measurements that are already required or permitted under existing accounting pronouncements with some exceptions. SFAS No. 157 retains the exchange price notion in defining fair value and clarifies that the exchange price is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability. It emphasizes that fair value is a market-based, not an entity-specific, measurement based upon the assumptions that market participants would use in pricing an asset or liability. As a basis for considering assumptions in fair value measurements, SFAS No. 157 establishes a hierarchy that gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). SFAS No. 157 expands disclosures about the use of fair value, including disclosure of the level within the hierarchy in which the fair value measurements fall and the effect of the measurements on earnings (or changes in net assets) for the period. The Company adopted SFAS No. 157 on January 1, 2008. The adoption of SFAS No. 157 had no impact on the Company's financial statements, but will impact the Company's fair value measurement disclosures in future periods.

**The fair value option for financial assets and financial liabilities.** In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, which should improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company adopted SFAS No. 159 on January 1, 2008 and the adoption had no impact on the Company's financial statements as the Company did not choose to measure additional items at fair value.

**Business combinations.** In December 2007, the FASB issued SFAS No. 141R, "Business Combinations." SFAS No. 141R requires an acquiring entity to recognize all the assets acquired and liabilities assumed at the acquisition-date fair value with limited exceptions. Under SFAS No. 141R, acquisition costs will generally be expensed as incurred, noncontrolling interests will be valued at acquisition-date fair value, and acquired contingent liabilities will be recorded at acquisition-date fair value and subsequently measured at the higher of such amount or the amount determined under existing guidance for non-acquired contingencies. The Company must adopt SFAS No. 141R for all business combinations for which the acquisition date is on or after January 1, 2009. Because the impact of adopting SFAS No. 141R will be dependent on future acquisitions, if any, management cannot predict such impact.

**Noncontrolling interests.** In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements." SFAS No. 160 requires the recognition of a noncontrolling interest (i.e., a minority interest) as equity in the consolidated financial statements, separate from the parent's equity, and requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the income statement. Under SFAS No. 160, changes in the parent's ownership interest that leave control intact are accounted for as capital transactions (i.e., as increases or decreases in ownership), a gain or loss will be recognized when a subsidiary is deconsolidated based on the fair value of the noncontrolling equity investment (not carrying amount), and entities must provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and of the noncontrolling owners. The Company must adopt SFAS No. 160 on January 1, 2009 prospectively, except for the presentation and disclosure requirements which must be applied retrospectively. Management has not yet determined what impact, if any, the adoption of SFAS No. 160 will have on the Company's financial statements.

**Reclassifications**

Certain reclassifications have been made to prior years' financial statements to conform to the 2007 presentation.

## 2. Cumulative preferred stock

The following series of cumulative preferred stock are redeemable only at the option of the respective company at the following prices in the event of voluntary liquidation or redemption:

| December 31, 2007 | Voluntary Liquidation Price | Redemption Price |
|---|---|---|
| *Series* | | |
| C, D, E, H, J and K (HECO) | $ 20 | $ 21 |
| I (HECO) | 20 | 20 |
| G (HELCO) | 100 | 100 |
| H (MECO) | 100 | 100 |

HECO is obligated to make dividend, redemption and liquidation payments on the preferred stock of either of its subsidiaries if the respective subsidiary is unable to make such payments, but such obligation is subordinated to any obligation to make payments on HECO's own preferred stock.

## 3. Unconsolidated variable interest entities

***HECO Capital Trust III.*** HECO Capital Trust III (Trust III) was created and exists for the exclusive purposes of (i) issuing in March 2004 2,000,000 6.50% Cumulative Quarterly Income Preferred Securities, Series 2004 (2004 Trust Preferred Securities) ($50 million aggregate liquidation preference) to the public and trust common securities ($1.5 million aggregate liquidation preference) to HECO, (ii) investing the proceeds of these trust securities in 2004 Debentures issued by HECO in the principal amount of $31.5 million and issued by each of MECO and HELCO in the respective principal amounts of $10 million, (iii) making distributions on the trust securities and (iv) engaging in only those other activities necessary or incidental thereto. The 2004 Trust Preferred Securities are mandatorily redeemable at the maturity of the underlying debt on March 18, 2034, which maturity may be extended to no later than March 18, 2053; and are redeemable at the issuer's option without premium beginning on March 18, 2009. The 2004 Debentures, together with the obligations of HECO, HELCO and MECO under an expense agreement and HECO's obligations under its trust guarantee and its guarantee of the obligations of HELCO and MECO under their respective debentures, are the sole assets of Trust III. Trust III has at all times been an unconsolidated subsidiary of HECO. Since HECO, as the common security holder, does not absorb the majority of the variability of Trust III, HECO is not the primary beneficiary and does not consolidate Trust III in accordance with FIN 46R. Trust III's balance sheet as of December 31, 2007 consisted of $51.5 million of 2004 Debentures; $50.0 million of 2004 Trust Preferred Securities; and $1.5 million of trust common securities. Trust III's income statement for 2007 consisted of $3.4 million of interest income received from the 2004 Debentures; $3.3 million of distributions to holders of the Trust Preferred Securities; and $0.1 million of common dividends on the trust common securities to HECO. So long as the 2004 Trust Preferred Securities are outstanding, HECO is not entitled to receive any funds from Trust III other than pro rata distributions, subject to certain subordination provisions, on the trust common securities. In the event of a default by HECO in the performance of its obligations under the 2004 Debentures or under its Guarantees, or in the event HECO, HELCO or MECO elect to defer payment of interest on any of their respective 2004 Debentures, then HECO will be subject to a number of restrictions, including a prohibition on the payment of dividends on its common stock.

***Purchase power agreements.*** As of December 31, 2007, HECO and its subsidiaries had six PPAs for a total of 540 MW of firm capacity, and other PPAs with smaller independent power producers (IPPs) and Schedule Q providers that supplied as-available energy. Approximately 91% of the 540 MW of firm capacity is under PPAs, entered into before December 31, 2003, with AES Hawaii, Inc. (AES Hawaii), Kalaeloa Partners, L.P. (Kalaeloa), Hamakua Energy Partners, L.P. (HEP) and HPOWER. Purchases from all IPPs for 2007 totaled $537 million, with purchases from AES Hawaii, Kalaeloa, HEP and HPOWER totaling $137 million, $193 million, $70 million and $38 million, respectively. The primary business activities of these IPPs are the generation and sale of power to HECO and its subsidiaries (and municipal waste disposal in the case of HPOWER). Current financial information about the size, including total assets and revenues, for many of these IPPs is not publicly available.

Under FIN 46R, an enterprise with an interest in a VIE or potential VIE created before December 31, 2003 (and not thereafter materially modified) is not required to apply FIN 46R to that entity if the enterprise is unable to obtain, after making an exhaustive effort, the necessary information.

HECO reviewed its significant PPAs and determined in 2004 that the IPPs at that time had no contractual obligation to provide such information. In March 2004, HECO and its subsidiaries sent letters to all of their IPPs, except the Schedule Q providers, requesting the information that they need to determine the applicability of FIN 46R to the respective IPP, and subsequently contacted most of the IPPs to explain and repeat its request for information. (HECO and its subsidiaries excluded their Schedule Q providers from the scope of FIN 46R because their variable interest in the provider would not be significant to the utilities and they did not participate significantly in the design of the provider.) Some of the IPPs provided sufficient information for HECO to determine that the IPP was not a VIE, or was either a "business" or "governmental organization" (HPOWER) as defined under FIN 46R, and thus excluded from the scope of FIN 46R. Other IPPs, including the three largest, declined to provide the information necessary for HECO to determine the applicability of FIN 46R, and HECO was unable to apply FIN 46R to these IPPs.

As required under FIN 46R, HECO has continued after 2004 its efforts to obtain from the IPPs the information necessary to make the determinations required under FIN 46R. In January 2005, 2006, 2007 and 2008, HECO and its subsidiaries sent letters to the IPPs that were not excluded from the scope of FIN 46R, requesting the information required to determine the applicability of FIN 46R to the respective IPP. All of these IPPs declined to provide necessary information, except that Kalaeloa provided the information pursuant to the amendments to the PPA (see below) and Kaheawa Wind Power, LLC (KWP) provided information as required under the PPA. Management has concluded that MECO does not have to consolidate KWP (which began selling power to MECO in June 2006 from its 30 MW windfarm) as MECO does not have a variable interest in KWP because the PPA does not require MECO to absorb variability of KWP.

If the requested information is ultimately received from the other IPPs, a possible outcome of future analysis is the consolidation of one or more of such IPPs in HECO's consolidated financial statements. The consolidation of any significant IPP could have a material effect on HECO's consolidated financial statements, including the recognition of a significant amount of assets and liabilities and, if such a consolidated IPP were operating at a loss and had insufficient equity, the potential recognition of such losses. If HECO and its subsidiaries determine they are required to consolidate the financial statements of such an IPP and the consolidation has a material effect, HECO and its subsidiaries would retrospectively apply FIN 46R in accordance with SFAS No. 154, "Accounting Changes and Error Corrections."

**Kalaeloa Partners, L.P.** In October 1988, HECO entered into a PPA with Kalaeloa, subsequently approved by the PUC, which provided that HECO would purchase 180 MW of firm capacity for a period of 25 years beginning in May 1991. In October 2004, HECO and Kalaeloa entered into amendments to the PPA, subsequently approved by the PUC, which together effectively increased the firm capacity from 180 MW to 208 MW. The energy payments that HECO makes to Kalaeloa include: 1) a fuel component, with a fuel price adjustment based on the cost of low sulfur fuel oil, 2) a fuel additives cost component, and 3) a non-fuel component, with an adjustment based on changes in the Gross National Product Implicit Price Deflator. The capacity payments that HECO makes to Kalaeloa are fixed in accordance with the PPA.

Kalaeloa is a Delaware limited partnership formed on October 13, 1988 for the purpose of designing, constructing, owning and operating a 200 MW cogeneration facility on Oahu, which includes two 75 MW oil-fired combustion turbines, two waste heat recovery steam generators, a 50 MW turbine generator and other electrical, mechanical and control equipment. The two combustion turbines were upgraded during 2004 resulting in an increase in the facility's nominal output rating to approximately 220 MW. Kalaeloa has a PPA with HECO (described above) and a steam delivery contract with another customer, the term of which coincides with the PPA. The facility has been certified by the Federal Energy Regulatory Commission as a Qualifying Facility under the Public Utility Regulatory Policies Act of 1978 (PURPA).

Pursuant to the provisions of FIN 46R, HECO is deemed to have a variable interest in Kalaeloa by reason of the provisions of HECO's PPA with Kalaeloa. However, management has concluded that HECO is not the primary beneficiary of Kalaeloa because HECO does not absorb the majority of Kalealoa's expected losses nor receive a majority of Kalaeloa's expected residual returns and, thus, HECO has not consolidated Kalaeloa in its consolidated financial statements. A significant factor affecting the level of expected losses HECO would absorb is the fact that HECO's exposure to fuel price variability is limited to the remaining term of the PPA as compared to the facility's remaining useful life. Although HECO absorbs fuel price variability for the remaining term of the PPA, the PPA does not currently expose HECO to losses as the fuel and fuel related energy payments under the PPA have been approved by the PUC for recovery from customers through base electric rates and through HECO's ECAC to the extent the fuel and fuel related energy payments are not included in base energy rates.

**Apollo Energy Corporation.** In October 2004, HELCO and Apollo Energy Corporation (Apollo) executed a restated and amended PPA which enables Apollo to repower its 7 MW facility, and install additional capacity, for a total allowed capacity of 20.5 MW. In December 2005, Apollo assigned the PPA to a subsidiary, which voluntarily, unilaterally and irrevocably waived and relinquished its right and benefit under the PPA to collect the floor rate for the entire term of the PPA. The 20.5 MW facility began commercial operations in April 2007. Based on information available, management concluded that HELCO does not have to consolidate Apollo as HELCO does not have a variable interest in Apollo because the PPA does not require HELCO to absorb any variability of Apollo.

## 4. Long-term debt

For special purpose revenue bonds, funds on deposit with trustees represent the undrawn proceeds from the issuance of the special purpose revenue bonds and earn interest at market rates. These funds are available only to pay (or reimburse payment of) expenditures in connection with certain authorized construction projects and certain expenses related to the bonds.

On March 27, 2007, the Department of Budget and Finance of the State of Hawaii (the Department) issued (pursuant to a 2005 legislative authorization), at par, Series 2007A SPRBs in the aggregate principal amount of $140 million, with a maturity of March 1, 2037 and a fixed coupon interest rate of 4.65%, and loaned the proceeds to HECO ($100 million), HELCO ($20 million) and MECO ($20 million). Payment of the principal and interest on the SPRBs are insured by a surety bond issued by Financial Guaranty Insurance Company. Proceeds will be used to finance capital expenditures, including reimbursements to the electric utilities for previously incurred capital expenditures which, in turn, will be used primarily to repay short-term borrowings. As of December 31, 2007, approximately $22 million of proceeds from the Series 2007A SPRBs had not yet been drawn and were held by the construction fund trustee. HECO, HELCO and MECO's long-term debt will increase from time to time as these remaining proceeds are drawn down.

On March 27, 2007, the Department also issued, at par, Refunding Series 2007B SPRBs in the aggregate principal amount of $125 million, with a maturity of May 1, 2026 and a fixed coupon interest rate of 4.60%, and loaned the proceeds to HECO ($62 million), HELCO ($8 million) and MECO ($55 million). Proceeds from the sale were applied, together with other funds provided by the electric utilities, to the redemption at par on May 1, 2007 of the $75 million aggregate principal amount of 6.20% Series 1996A SPRBs (which had an original maturity of May 1, 2026) and to the redemption at a 2% premium on April 27, 2007 of the $50 million aggregate principal amount of 5 7/8% Series 1996B SPRBs (which had an original maturity of December 1, 2026). Payment of the principal and interest on the refunding SPRBs are insured by a surety bond issued by Financial Guaranty Insurance Company.

At December 31, 2007, the aggregate payments of principal required on long-term debt are nil during the next four years and $57.5 million in 2012.

## 5. Short-term borrowings

Short-term borrowings from nonaffiliates at December 31, 2007 and 2006 had a weighted average interest rate of 5.4%, and consisted entirely of commercial paper.

At December 31, 2007 and 2006 the Company maintained a syndicated credit facility of $175 million. The facility is not secured. There were no borrowings under any line of credit during 2007 and 2006.

***Credit agreement.*** Effective April 3, 2006, HECO entered into a revolving unsecured credit agreement establishing a line of credit facility of $175 million with a syndicate of eight financial institutions. On March 14, 2007 the PUC issued a D&O approving HECO's request to maintain the credit facility for five years (until March 31, 2011), to borrow under the credit facility (including borrowings with maturities in excess of 364 days), to use the proceeds from any borrowings with maturities in excess of 364 days to finance capital expenditures and/or to repay short-term or other borrowings used to finance or refinance capital expenditures and to use an expedited approval process to obtain PUC approval to increase the facility amount, renew the facility, refinance the facility or change other terms of the facility if such changes are required or desirable.

Any draws on the facility bear interest, at the option of HECO, at either the "Adjusted LIBO Rate" plus 40 basis points or the greater of (a) the "Prime Rate" and (b) the sum of the "Federal Funds Rate" plus 50 basis points, as defined in the agreement. The annual fee is 8 basis points on the undrawn commitment amount. The agreement contains provisions for revised pricing in the event of a ratings change. For example, a ratings downgrade of HECO's Senior Debt Rating (e.g., from BBB+/Baa1 to BBB/Baa2 by S&P and Moody's, respectively) would result in a commitment fee increase of 2 basis points and an interest rate increase of 10 basis points on any drawn amounts. On the other hand, a ratings upgrade (e.g., from BBB+/Baa1 to A-/A3) would result in a commitment fee decrease of 1 basis point and an interest rate decrease of 10 basis points on any drawn amounts. The agreement does not contain clauses that would affect access to the lines by reason of a ratings downgrade, nor does it have a broad "material adverse change" clause. However, the agreement does contain customary conditions that must be met in order to draw on it, such as the accuracy of certain of its representations at the time of a draw and compliance with its covenants (such as covenants preventing its subsidiaries from entering into agreements that restrict the ability of the subsidiaries to pay dividends to, or to repay borrowings from, HECO, and restricting HECO's ability, as well as the ability of any of its subsidiaries, to guarantee indebtedness of the subsidiaries if such additional debt would cause the subsidiary's "Consolidated Subsidiary Funded Debt to Capitalization Ratio" to exceed 65% (ratios of 47% for HELCO and 45% for MECO as of December 31, 2007, as calculated under the agreement)). In addition to customary defaults, HECO's failure to maintain its financial ratios, as defined in its agreement, or meet other requirements will result in an event of default. For example, under the agreement, it is an event of default if HECO fails to maintain a "Consolidated Capitalization Ratio" (equity) of at least 35% (ratio of 54% as of December 31, 2007, as calculated under the agreement), if HECO fails to remain a wholly-owned subsidiary of HEI or if any event or condition occurs that results in any "Material Indebtedness" of HECO or any of its significant subsidiaries being subject to acceleration prior to its scheduled maturity. HECO's syndicated credit facility is maintained to support the issuance of commercial paper, but it may also be drawn for general corporate purposes and capital expenditures.

On May 23, 2007, S&P lowered the long-term corporate credit and unsecured debt ratings on HECO, HELCO and MECO to BBB from BBB+ and stated that the downgrade "is the result of sustained weak bondholder protection parameters compounded by the financial pressure that continuous need for regulatory relief, driven by heightened capital expenditure requirements, is creating for the next few years." The pricing for future borrowings under the line of credit facility did not change since the pricing level is "determined by the higher of the two" ratings by S&P and Moody's, and Moody's ratings did not change.

## 6. Regulatory assets and liabilities

In accordance with SFAS No. 71, the Company's financial statements reflect assets, liabilities, revenues and expenses based on current cost-based rate-making regulations. Continued accounting under SFAS No. 71 generally requires that rates are established by an independent, third-party regulator; rates are designed to recover the costs of providing service; and it is reasonable to assume that rates can be charged to and collected from customers. Management believes its operations currently satisfy the SFAS No. 71 criteria. If events or circumstances should change so that those criteria are no longer satisfied, the Company expects that the regulatory assets would be charged to expense and the regulatory liabilities would be credited to income or refunded to ratepayers. In the event of unforeseen regulatory actions or other circumstances, management believes that a material adverse effect on the Company's results of operations and financial position may result if regulatory assets have to be charged to expense without an offsetting credit for regulatory liabilities or if regulatory liabilities are required to be refunded to ratepayers.

Regulatory assets represent deferred costs expected to be fully recovered through rates over PUC authorized periods. Generally, the Company does not earn a return on its regulatory assets, however, it has been allowed to recover interest on its regulatory assets for demand-side management program costs. Regulatory liabilities represent amounts included in rates and collected from ratepayers for costs expected to be incurred in the future. For example, the regulatory liability for cost of removal in excess of salvage value represents amounts that have been collected from ratepayers for costs that are expected to be incurred in the future to retire utility plant. Noted in parenthesis are the original PUC authorized amortization or recovery periods and the remaining amortization or recovery periods as of December 31, 2007, if different.

Regulatory assets were as follows:

| December 31 | 2007 | 2006 |
|---|---|---|
| (in thousands) | | |
| Retirement benefit plans (5 years for HELCO's $10 million prepaid pension regulatory asset, indeterminate for remainder) | $169,814 | $ - |
| Income taxes, net (1 to 36 years) | 74,605 | 73,178 |
| Postretirement benefits other than pensions (18 years; 5 years) | 8,949 | 10,738 |
| Unamortized expense and premiums on retired debt and equity issuances (14 to 30 years; 1 to 21 years) | 17,510 | 14,909 |
| Demand-side management program costs, net (1 year) | 4,113 | 4,521 |
| Vacation earned, but not yet taken (1 year) | 5,997 | 5,759 |
| Other (1 to 20 years) | 4,002 | 3,244 |
| | $ 284,990 | $ 112,349 |

The regulatory asset relating to retirement benefit plans was created as a result of pension and OPEB tracking mechanisms adopted by the PUC in interim rate case decisions for HECO, MECO and HELCO in 2007 (see Note 10).

Regulatory liabilities were as follows:

| December 31 | 2007 | 2006 |
|---|---|---|
| (in thousands) | | |
| Cost of removal in excess of salvage value (1 to 60 years) | $259,765 | $239,049 |
| Other (5 years; 2 to 5 years) | 1,841 | 1,570 |
| | $261,606 | $240,619 |

## 7. Income taxes

In June 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109," which prescribes a "more-likely-than-not" recognition threshold and measurement attribute (the largest amount of benefit that is greater than 50% likely of being realized upon ultimate resolution with tax authorities) for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. The Company adopted FIN 48 in the first quarter of 2007.

As a result of the implementation of FIN 48, the Company reclassified certain deferred tax liabilities to a liability for uncertain tax positions (FIN 48 liability) and reduced retained earnings by $0.6 million as of January 1, 2007 for the cumulative effect of adoption of FIN 48.

The Company records interest on income taxes in "Interest and other charges." For 2007, 2006 and 2005, interest (income) expense on income taxes was $0.6 million, ($0.3) million and ($0.7) million, respectively.

The Company will record penalties, if any, in "Other, net" under "Other income". As of December 31, 2007 and January 1, 2007 (implementation date), the total amount of accrued interest related to uncertain tax positions and recognized on the balance sheet was $1.2 million and $.6 million, respectively.

As of December 31, 2007, the total amount of FIN 48 liability was $5.5 million and, of this amount, $0.3 million, if recognized, would affect the Company's effective tax rate. Management concluded that it is reasonably possible that the FIN 48 liability will significantly change within the next 12 months due to the resolution of issues under examination by the Internal Revenue Service. Management cannot estimate the range of the reasonably possible change.

The changes in total unrecognized tax benefits were as follows:

| Year ended December 31 | 2007 |
|---|---|
| (in millions) | |
| Unrecognized tax benefits, January 1 | $ 23.6 |
| Additions based on tax positions taken during the year | – |
| Reductions based on tax positions taken during the year | – |
| Additions for tax positions of prior years | 0.8 |
| Reductions for tax positions of prior years | – |
| Decreases due to tax positions taken | – |
| Settlements | – |
| Lapses of statute of limitations | – |
| Unrecognized tax benefits, December 31 | $ 24.4 |

In addition to the FIN 48 liability, the unrecognized tax benefits include $18.9 million of tax benefits related to refund claims, which did not meet the recognition threshold. Consequently, tax benefits have not been recorded on these claims and no FIN 48 liability was required to offset these potential benefits.

Tax years 2003 to 2006 currently remain subject to examination by the Internal Revenue Service and Department of Taxation of the State of Hawaii.

The Company's effective federal and state income tax rate for 2007 was 37%, compared to an effective tax rate for 2006 of 38%. The lower effective tax rate was primarily due to domestic production activities deductions related to the generation of electricity and the impact of state tax credits (including the acceleration of the state tax credits associated with the write-off of a portion of CT-4 and CT-5 costs) recognized against a smaller income tax expense base.

The components of income taxes charged to operating expenses were as follows:

| December 31 | 2007 | 2006 | 2005 |
|---|---|---|---|
| (in thousands) | | | |
| Federal: | | | |
| Current | $54,767 | $50,208 | $23,799 |
| Deferred | (22,853) | (7,000) | 17,497 |
| Deferred tax credits, net | (1,154) | (1,259) | (1,351) |
| | 30,760 | 41,949 | 39,945 |
| State: | | | |
| Current | 5,073 | 2,889 | (1,407) |
| Deferred | (3,699) | (1,267) | 3,020 |
| Deferred tax credits, net | 1,992 | 3,810 | 3,471 |
| | 3,366 | 5,432 | 5,084 |
| Total | $34,126 | $47,381 | $45,029 |

Income tax benefits related to nonoperating activities, included in "Other, net" on the consolidated statements of income, amounted to $3.2 million, $0.9 million and $0.4 million for 2007, 2006 and 2005, respectively.

A reconciliation between income taxes charged to operating expenses and the amount of income taxes computed at the federal statutory rate of 35% on income before income taxes and preferred stock dividends follows:

| December 31 | 2007 | 2006 | 2005 |
|---|---|---|---|
| (in thousands) | | | |
| Amount at the federal statutory income tax rate | $32,559 | $44,024 | $41,989 |
| State income taxes on operating income, net of effect on federal income taxes | 2,188 | 3,530 | 3,305 |
| Other | (621) | (173) | (265) |
| Income taxes charged to operating expenses | $34,126 | $47,381 | $45,029 |

The tax effects of book and tax basis differences that give rise to deferred tax assets and liabilities were as follows:

| December 31 | 2007 | 2006 |
|---|---|---|
| (in thousands) | | |
| Deferred tax assets: | | |
| Cost of removal in excess of salvage value | $ 101,075 | $ 93,014 |
| Retirement benefits in AOCI | -- | 80,665 |
| Contributions in aid of construction and customer advances | 76,342 | 38,582 |
| Other | 21,753 | 9,534 |
| | 199,170 | 221,795 |
| Deferred tax liabilities: | | |
| Property, plant and equipment | 287,231 | 279,539 |
| Regulatory assets, excluding amounts attributable to property, plant and equipment | 29,050 | 28,495 |
| Retirement benefits | 15,590 | 26,862 |
| Change in accounting method | 23,036 | -- |
| Retirement benefits in AOCI | 736 | -- |
| Other | 5,640 | 4,954 |
| | 361,283 | 339,850 |
| Net deferred income tax liability | $162,113 | $118,055 |

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Based upon historical taxable income, projections for future taxable income and available tax planning strategies, management believes it is more likely than not the Company will realize substantially all of the benefits of the deferred tax assets.

As of December 31, 2007, the FIN 48 disclosures above present the Company's accrual for potential tax liabilities and related interest. Based on information currently available, the Company believes this accrual has adequately provided for potential income tax issues with federal and state tax authorities and related interest, and that the ultimate resolution of tax issues for all open tax periods will not have a material adverse effect on its results of operations, financial condition or liquidity.

## 8. Cash flows

**Supplemental disclosures of cash flow information**

Cash paid for interest (net of AFUDC-Debt) and income taxes was as follows:

| Years ended December 31 (in thousands) | 2007 | 2006 | 2005 |
|---|---|---|---|
| Interest | $47,155 | $47,206 | $46,221 |
| Income taxes | $26,106 | $52,782 | $20,554 |

**Supplemental disclosures of noncash activities**

The allowance for equity funds used during construction, which was charged primarily to construction in progress, amounted to $5.2 million, $6.3 million and $5.1 million in 2007, 2006 and 2005, respectively.

The estimated fair value of noncash contributions in aid of construction amounted to $17.7 million, $13.5 million and $11.8 million in 2007, 2006 and 2005, respectively.

## 9. Major customers

HECO and its subsidiaries received approximately 9% ($193 million), 10% ($197 million) and 10% ($176 million), of their operating revenues from the sale of electricity to various federal government agencies in 2007, 2006 and 2005, respectively.

## 10. Retirement benefits

***Pensions***

Substantially all of the employees of HECO, HELCO and MECO participate in the Retirement Plan for Employees of Hawaiian Electric Industries, Inc. and Participating Subsidiaries (the Plan). The Plan is a qualified, non-contributory defined benefit pension plan and includes benefits for union employees determined in accordance with the terms of the collective bargaining agreements between the utilities and their respective unions. The Plan is subject to the provisions of the ERISA. In addition, some current and former executives and directors participate in noncontributory, nonqualified plans (collectively, Supplemental/Excess/Directors Plans). In general, benefits are based on the employees' years of service and compensation.

The continuation of the Plan and the Supplemental/Excess/Directors Plans and the payment of any contribution thereunder are not assumed as contractual obligations by the participating employers. The Directors' Plan has been frozen since 1996, and no participants have accrued any benefits after that time. The plan will be terminated at the time all remaining benefits have been paid.

Each participating employer reserves the right to terminate its participation in the applicable plans at any time. If a participating employer terminates its participation in the Plan, the interest of each affected participant would become 100% vested to the extent funded. Upon the termination of the Plan, assets would be distributed to affected participants in accordance with the applicable allocation provisions of ERISA and any excess assets that exist would be paid to the participating employers. Participants' benefits in the Plan are covered up to certain limits under insurance provided by the Pension Benefit Guaranty Corporation.

To determine pension costs for HECO, HELCO and MECO under the Plan and the Supplemental/Excess/Directors Plans, it is necessary to make complex calculations and estimates based on numerous assumptions, including the assumptions identified below.

***Postretirement benefits other than pensions***

The Company provides eligible employees health and life insurance benefits upon retirement under the Postretirement Welfare Benefits Plan for Employees of Hawaiian Electric Company, Inc. and participating employers (HECO Benefits Plan). Health benefits are also provided to dependents of eligible retired employees. The contribution for health benefits paid by the participating employers is based on the retirees' years of service and retirement dates. Generally, employees are eligible for these benefits if, upon retirement from active employment, they are eligible to receive benefits from the Plan.

Among other provisions, the HECO Benefits Plan provides prescription drug benefits for Medicare-eligible participants who retire after 1998. Retirees who are eligible for the drug benefits are required to pay a portion of the cost each month. The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the 2003 Act) was signed into law on December 8, 2003. The 2003 Act expanded Medicare to include for the first time coverage for prescription drugs. The 2003 Act provides that persons eligible for Medicare benefits can enroll in Part D, prescription drug coverage, for a monthly premium. Alternatively, if an employer sponsors a retiree health plan that provides benefits determined to be actuarially equivalent to those covered under the Medicare standard prescription drug benefit, the employer will be paid a subsidy of 28 percent of a participant's drug costs between $250 and $5,000 (to be indexed for inflation) if the participant waives coverage under Medicare Part D.

The continuation of the HECO Benefits Plan and the payment of any contribution thereunder is not assumed as a contractual obligation by the participating employers. Each participating employer reserves the right to terminate its participation in the plan at any time.

***SFAS No. 158***

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)," which requires employers to recognize on their balance sheets the funded status of defined benefit pension and other postretirement benefit plans with an offset to AOCI in stockholders' equity (using the projected benefit obligation, rather than the accumulated benefit obligation, to calculate the funded status of pension plans).

By application filed on December 8, 2005 (AOCI Docket), the Company had requested the PUC to permit it to record, as a regulatory asset pursuant to SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," the amount that would otherwise be charged against stockholders' equity as a result of recording a minimum pension liability as prescribed by SFAS No. 87. The Company updated its application in the AOCI Docket in November 2006 to take into account SFAS No. 158. On January 26, 2007, the PUC issued a D&O in the updated AOCI Docket, which denied the Company's request to record a regulatory asset on the grounds that the Company had not met its burden of proof to show that recording a regulatory asset was warranted, or that there would be adverse consequences if a regulatory asset was not recorded. The PUC also required HECO to submit a pension study (determining whether ratepayers are better off with a well-funded pension plan, a minimally-funded pension plan, or something in between) in its pending 2007 test year rate case, as proposed by the Company in support of their request.

In HELCO's 2006, HECO's 2007 and MECO's 2007 test year rate cases, the Company and the Consumer Advocate proposed adoption of pension and OPEB tracking mechanisms, which are intended to smooth the impact to ratepayers of potential fluctuations in pension and OPEB costs. Under the tracking mechanisms, any costs determined under SFAS Nos. 87 and 106, as amended, that are over/under amounts allowed in rates are charged/credited to a regulatory asset/liability. The regulatory asset/liability for each utility will be amortized over 5 years beginning with the respective utility's next rate case.

The pension tracking mechanisms generally require the Company to fund only the minimum level required under the law until the existing pension assets are reduced to zero, at which time the Company would make contributions to the pension trust in the amount of the actuarially calculated net periodic pension costs, except when limited by the ERISA minimum contribution requirements or the maximum contribution limitation on deductible contributions imposed by the Internal Revenue code. The OPEB tracking mechanisms generally require the Company to make contributions to the OPEB trust in the amount of the actuarially calculated net periodic benefit costs, except when limited by material, adverse consequences imposed by federal regulations.

A pension funding study was filed in the HECO rate case in May 2007. The conclusions in the study were consistent with the funding practice proposed with the pension tracking mechanism.

In its 2007 interim decisions for HELCO's 2006, HECO's 2007 and MECO's 2007 test year rate cases, the PUC approved the adoption of the proposed pension and OPEB tracking mechanisms on an interim basis (subject to the PUC's final D&Os) and established the amount of net periodic benefit costs to be recovered in rates by each utility.

Under HELCO's interim order, a regulatory asset (representing HELCO's $12.8 million prepaid pension asset as of December 31, 2006 prior to the adoption of SFAS No. 158) was allowed to be recovered (and is being amortized) over a period of five years and was allowed to be included in HELCO's rate base, net of deferred income taxes. On October 25, 2007, however, the PUC issued an amended proposed final D&O for HECO's 2005 test year rate case, which when issued in final form, would reverse the portion of the interim D&O related to the inclusion of HECO's approximately $50 million pension asset, net of deferred income taxes, in rate base, and would require a refund of revenues associated with that reversal, including interest, retroactive to September 28, 2005 (the date the interim increase became effective). In 2007, HECO accrued $16 million for the potential customer refunds, including interest, reducing 2007 net income by $9 million. In the settlement agreement and interim PUC decision in HECO's 2007 test year rate case, HECO's pension asset was not included in HECO's rate base and amortization of the pension asset was not included as part of the pension tracking mechanism adopted in the proceeding on an interim basis. The issue of whether to amortize HECO's prepaid pension asset ($51 million at December 31, 2007), if allowed to be included in rate base by the PUC, has thus been deferred until HECO's next rate case proceeding. Similarly, in the settlement agreement and interim PUC decision in MECO's 2007 test year rate case, MECO's pension asset ($1 million as of December 31, 2007) was not included in MECO's rate base and amortization of the pension asset was not included as part of the pension tracking mechanism adopted in the proceeding on an interim basis.

As a result of the 2007 interim orders, the Company has reclassified to a regulatory asset charges for retirement benefits that would otherwise be recorded in accumulated other comprehensive income pursuant to SFAS No. 158 (amounting to the elimination of a potential charge to AOCI at December 31, 2007 of $171 million pre-tax, compared to a retirement benefits pre-tax charge of $207 million at December 31, 2006).

Retirement benefits expense for the Company for 2007, 2006 and 2005 was $27 million, $22 million and $13 million, respectively.

***Pension and other postretirement benefit plans information***

The changes in the obligations and assets of the Company's retirement benefit plans and the changes in AOCI (gross) for 2007 and 2006 and the funded status of these plans and amounts related to these plans reflected in the Company's balance sheet as of December 31, 2007 and 2006 were as follows:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| (in thousands) | Pension benefits | Other benefits | Pension benefits | Other benefits |
| Benefit obligation, January 1 | $877,365 | $186,359 | $ 859,080 | $185,839 |
| Service cost | 25,527 | 4,652 | 26,719 | 4,965 |
| Interest cost | 51,588 | 10,512 | 48,348 | 10,337 |
| Amendments | – | – | 116 | – |
| Actuarial gain | (7,084) | (10,671) | (14,925) | (5,350) |
| Benefits paid and expenses | (44,384) | (8,926) | (41,973) | (9,432) |
| Benefit obligation, December 31 | 903,012 | 181,926 | 877,365 | 186,359 |
| Fair value of plan assets, January 1 | 784,163 | 133,815 | 730,101 | 117.352 |
| Actual return on plan assets | 67,378 | 11,390 | 95,909 | 15,656 |
| Employer contribution | 2,846 | 9,293 | – | 9,789 |
| Benefits paid and expenses | (44,486) | (8,974) | (41,847) | (8,982) |
| *Fair value of plan assets, December 31* | *809,901* | *145,524* | *784,163* | *133,815* |
| Accrued benefit liability, December 31 | (93,111) | (36,402) | (93,202) | (52,544) |
| AOCI, January 1 | 176,057 | 31,258 | 45 | – |
| Recognized during year – net recognized transition obligation | (1) | (3,130) | (2) | (3,130) |
| Recognized during year – prior service (cost)/credit | 762 | – | 770 | – |
| Recognized during year – net actuarial losses | (10,486) | – | (10,699) | (388) |
| Occurring during year – prior service cost | – | – | 115 | – |
| Occurring during year – net actuarial gains | (13,126) | (12,219) | (46,367) | (11,248) |
| Other adjustments | – | – | 232,195 | 46,024 |
| | 153,206 | 15,909 | 176,057 | 31,258 |
| Impact of PUC D&Os | (152,888) | (18,120) | – | – |
| AOCI, December 31 | 318 | (2,211) | 176,057 | 31,258 |
| Net actuarial loss | 157,324 | 260 | 180,937 | 12,480 |
| Prior service gain | (4,118) | – | (4,881) | – |
| Net transition obligation | – | 15,649 | 1 | 18,778 |
| | 153,206 | 15,909 | 176,057 | 31,258 |
| Impact of PUC D&Os | (152,888) | (18,120) | – | – |
| AOCI, December 31 | 318 | (2,211) | 176,057 | 31,258 |
| Income tax benefits | (124) | 860 | (68,503) | (12,162) |
| AOCI, net of taxes, December 31 | $ 194 | $ (1,351) | $ 107,554 | $ 19,096 |

The Company does not expect any plan assets to be returned to the Company during calendar year 2008.

The dates used to determine retirement benefit measurements for the defined benefit plans were December 31 of 2007, 2006 and 2005.

The defined benefit pension plans' accumulated benefit obligations, which do not consider projected pay increases (unlike the projected benefit obligations shown in the table above), as of December 31, 2007 and 2006 were $794 million and $769 million, respectively.

The Company has determined the market-related value of retirement benefit plan assets by calculating the difference between the expected return and the actual return on the fair value of the plan assets, then amortizing the difference over future years – 0% in the first year and 25% in years two to five, and finally adding or subtracting the unamortized differences for the past four years from fair value. The method includes a 15% range around the fair value of such assets (i.e., 85% to 115% of fair value). If the market-related value is outside the 15% range, then the amount outside the range will be recognized immediately in the calculation of annual net periodic benefit cost.

A primary goal of the plans is to achieve long-term asset growth sufficient to pay future benefit obligations at a reasonable level of risk. The investment policy target for defined benefit pension and OPEB plans reflects the philosophy that long-term growth can best be achieved by prudent investments in equity securities while balancing overall fund volatility by an appropriate allocation to fixed income securities. In order to reduce the level of portfolio risk and volatility in returns, efforts have been made to diversify the plans' investments by: asset class, geographic region, market capitalization and investment style.

The expected long-term rate of return assumption of 8.5% was based on the plans' asset allocation, projected asset class returns provided by the plans' actuarial consultant and the past performance of the plans' assets.

The weighted-average asset allocation of retirement defined benefit plans was as follows:

| | Pension benefits | | | | Other benefits | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Investment policy | | | | Investment policy | |
| December 31 | 2007 | 2006 | Target | Range | 2007 | 2006 | Target | Range |
| Asset category | | | | | | | | |
| Equity securities | 72% | 72% | 70% | 65-75% | 70% | 71% | 70% | 65-75% |
| Fixed income | 27 | 27 | 30 | 25-35% | 30 | 29 | 30 | 25-35% |
| Other [1] | 1 | 1 | – | – | – | – | – | – |
| | 100% | 100% | 100% | | 100% | 100% | 100% | |

[1] Other includes alternative investments, which are relatively illiquid in nature and will remain as plan assets until an appropriate liquidation opportunity occurs.

The Company's current estimate of contributions to the retirement benefit plans in 2008 is $14 million.

As of December 31, 2007, the benefits expected to be paid under the retirement benefit plans in 2008, 2009, 2010, 2011, 2012 and 2013 through 2017 amounted to $57 million, $59 million, $61 million, $63 million, $66 million and $370 million, respectively.

The following weighted-average assumptions were used in the accounting for the plans:

| | Pension benefits | | | Other benefits | | |
|---|---|---|---|---|---|---|
| December 31 | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 |
| Benefit obligation | | | | | | |
| Discount rate | 6.125% | 6.00% | 5.75% | 6.125% | 6.00% | 5.75% |
| Expected return on plan assets | 8.5 | 8.5 | 9.0 | 8.5 | 8.5 | 9.0 |
| Rate of compensation increase | 4.0 | 4.0 | 4.6 | 4.0 | 4.0 | 4.6 |
| Net periodic benefit cost (years ended) | | | | | | |
| Discount rate | 6.00 | 5.75 | 6.00 | 6.00 | 5.75 | 6.00 |
| Expected return on plan assets | 8.5 | 9.0 | 9.0 | 8.5 | 9.0 | 9.0 |
| Rate of compensation increase | 4.0 | 4.6 | 4.6 | 4.0 | 4.6 | 4.6 |

As of December 31, 2007, the assumed health care trend rates for 2008 and future years were as follows: medical, 10.00%, grading down to 5.00% for 2013 and thereafter; dental, 5.00%; and vision, 4.00%. As of December 31, 2006, the assumed health care trend rates for 2007 and future years were as follows: medical, 10.00%, grading down to 5.00% for 2012 and thereafter; dental, 5.00%; and vision, 4.00%.

*The components of net periodic benefit cost were as follows:*

| | Pension benefits | | | Other benefits | | |
|---|---|---|---|---|---|---|
| Years ended December 31 | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 |
| (in thousands) | | | | | | |
| Service cost | $25,527 | $26,719 | $23,832 | $ 4,652 | $ 4,965 | $ 5,098 |
| Interest cost | 51,588 | 48,348 | 46,817 | 10,512 | 10,337 | 10,818 |
| Expected return on plan assets | (61,101) | (64,467) | (67,078) | (9,778) | (9,758) | (9,704) |
| Amortization of net transition obligation | 1 | 2 | 2 | 3,130 | 3,130 | 3,130 |
| Amortization of net prior service gain | (762) | (770) | (770) | – | – | – |
| Amortization of net actuarial loss | 10,486 | 10,699 | 4,735 | – | 388 | 395 |
| Net periodic benefit cost | 25,739 | 20,531 | 7,538 | 8,516 | 9,062 | 9,737 |
| Impact of PUC D&Os | 1,195 | – | – | 187 | – | – |
| Net periodic benefit cost (adjusted for impact of PUC D&Os) | $26,934 | $ 20,531 | $ 7,538 | $8,703 | $ 9,062 | $9,737 |

The estimated prior service credit, net actuarial loss and net transition obligation for defined benefits pension plans that will be amortized from AOCI or regulatory asset into net periodic pension benefit cost over 2008 are $(0.8) million, $6.6 million and nil, respectively. The estimated prior service cost, net actuarial loss and net transitional obligation for other benefit plans that will be amortized from AOCI or regulatory asset into net periodic other than pension benefit cost over 2008 are nil, nil and $3.1 million, respectively.

The Company recorded pension expense of $20 million, $15 million and $6 million and OPEB expense of $7 million each year in 2007, 2006 and 2005, respectively, and charged the remaining amounts primarily to electric utility plant.

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with an accumulated benefit obligation in excess of plan assets were $4 million, $3 million and nil, respectively, as of December 31, 2007 and December 31, 2006.

The health care cost trend rate assumptions can have a significant effect on the amounts reported for other benefits. As of December 31, 2007, a one-percentage-point increase in the assumed health care cost trend rates would have increased the total service and interest cost by $0.2 million and the postretirement benefit obligation by $3.1 million, and a one-percentage-point decrease would have reduced the total service and interest cost by $0.2 million and the postretirement benefit obligation by $3.5 million.

## 11. Commitments and contingencies

**Fuel contracts.** HECO and its subsidiaries have contractual agreements to purchase minimum quantities of fuel oil and diesel fuel through December 31, 2014 (at prices tied to the market prices of petroleum products in Singapore and Los Angeles). Based on the average price per barrel as of January 1, 2008, the estimated cost of minimum purchases under the fuel supply contracts is $0.9 billion per year for 2008 through 2012 and a total of $1.8 billion for the period 2013 through 2014. The actual cost of purchases in 2008 and future years could vary substantially from this estimate as a result of changes in market prices, quantities actually purchased and/or other factors. HECO and its subsidiaries purchased $795 million, $755 million and $662 million of fuel under contractual agreements in 2007, 2006 and 2005, respectively.

**Power purchase agreements (PPAs).** As of December 31, 2007, HECO and its subsidiaries had six firm capacity PPAs for a total of 540 megawatts (MW) of firm capacity. Purchases from these six independent power producers (IPPs) and all other IPPs totaled $537 million, $507 million and $458 million for 2007, 2006 and 2005, respectively. The PUC allows rate recovery for energy and firm capacity payments to IPPs under these agreements. Assuming that each of the agreements remains in place for its current term and the minimum availability criteria in the PPAs are met, aggregate minimum fixed capacity charges are expected to be approximately $0.1 billion per year for 2008 through 2012 and a total of $1.0 billion in the period from 2013 through 2030.

In general, HECO and its subsidiaries base their payments under the PPAs upon available capacity and energy and they are generally not required to make payments for capacity if the contracted capacity is not available, and payments are reduced, under certain conditions, if available capacity drops below contracted levels. In general, the payment rates for capacity have been predetermined for the terms of the agreements. Energy payments will vary over the terms of the agreements. HECO and its subsidiaries pass on changes in the fuel component of the energy charges to customers through the ECAC in their rate schedules (see "Energy cost adjustment clauses" below). HECO and its subsidiaries do not operate, or participate in the operation of, any of the facilities that provide power under the agreements. Title to the facilities does not pass to HECO or its subsidiaries upon expiration of the agreements, and the agreements do not contain bargain purchase options for the facilities.

**Interim increases.** On September 27, 2005, the PUC issued an interim decision and order (D&O) in HECO's 2005 test year rate case granting a general rate increase on Oahu of 4.36%, or $53.3 million (3.33%, or a net increase of $41.1 million excluding the transfer of certain costs from a surcharge line item on electric bills into base electricity charges), which was implemented on September 28, 2005.

On October 25, 2007, the PUC issued an amended proposed final D&O in HECO's 2005 test year rate case, authorizing an increase of 3.74%, or $45.7 million (or a net increase of $34 million or 2.7%), in annual revenues. The amended proposed final D&O, when issued in final form, would reverse the portion of the interim D&O related to the inclusion of HECO's approximately $50 million pension asset, net of deferred income taxes, in rate base, and would require a refund of the revenues associated with that reversal, including interest, retroactive to September 28, 2005 (the date the interim increase became effective), amounting to $16 million through December 31, 2007 ($9 million, net of tax benefits). Interest on the refund amount would continue to accrue until the amount is refunded to customers.

On April 4, 2007, the PUC issued an interim D&O in HELCO's 2006 test year rate case granting a general rate increase on the island of Hawaii of 7.58%, or $24.6 million, which was implemented on April 5, 2007.

On October 22, 2007, the PUC issued, and HECO immediately implemented, an interim D&O in HECO's 2007 test year rate case, granting HECO an increase of $69.997 million in annual revenues over current effective rates at the time of the interim decision.

On December 21, 2007, the PUC issued, and MECO immediately implemented, an interim D&O in MECO's 2007 test year rate case, granting MECO an increase of $13.2 million in annual revenues, or a 3.7% increase.

Through December 31, 2007, HECO and its subsidiaries had recognized $150 million of revenues with respect to interim orders ($14 million related to interim orders regarding certain integrated resource planning costs and $136 million related to interim orders with respect to HECO's interim surcharge to recover DG fuel and fuel trucking costs and general rate increase requests, not including revenues of $16 million for which a reserve, including interest, has been accrued to reflect the PUC's proposed final D&O in the 2005 HECO rate case), which revenues are subject to refund, with interest, if and to the extent they exceed the amounts allowed in final D&Os.

**Energy cost adjustment clauses.** On June 19, 2006, the PUC issued an order in HECO's 2005 test year rate case indicating that the record in the pending case had not been developed for the purpose of addressing the factors in Act 162, signed into law by the Governor of Hawaii on June 2, 2006. Act 162 states that any automatic fuel rate adjustment clause requested by a public utility in an application filed with the PUC shall be designed, as determined in the PUC's discretion, to (1) fairly share the risk of fuel cost changes between the public utility and its customers, (2) provide the public utility with sufficient incentive to reasonably manage or lower its fuel costs and encourage greater use of renewable energy, (3) allow the public utility to mitigate the risk of sudden or frequent fuel cost changes that cannot otherwise reasonably be mitigated through other commercially available means, such as through fuel hedging contracts, (4) preserve, to the extent reasonably possible, the public utility's financial integrity, and (5) minimize, to the extent reasonably possible, the public utility's need to apply for frequent applications for general rate increases to account for the changes to its fuel costs. While the PUC already had reviewed the automatic fuel rate adjustment clause in rate cases, Act 162 required that these five specific factors be addressed in the record. In October 2007, the PUC issued an amended proposed final D&O in HECO's 2005 test year rate case in which the PUC stated it would not require the parties in the rate case proceeding to file a stipulated procedural schedule on this issue, but that it expects HECO and HELCO to develop information relating to the Act 162 factors for examination during their next rate case proceedings.

The ECAC provisions of Act 162 were reviewed in the HELCO rate case based on a 2006 test year and are being reviewed in the HECO and MECO rate cases based on 2007 test years. In the HELCO 2006 test year rate case, the filed testimony of the Consumer Advocate's consultant concluded that HELCO's ECAC provides a fair sharing of the risks of fuel cost changes between HELCO and its ratepayers in a manner that preserves the financial integrity of HELCO without the need for frequent rate filings. On April 4, 2007 the PUC issued an interim D&O in the HELCO 2006 test year rate case which reflected the continuation of HELCO's ECAC, consistent with a settlement agreement reached between HELCO and the Consumer Advocate.

In an order issued on August 24, 2007, the PUC added as an issue to be addressed in HECO's 2007 test year rate case whether HECO's ECAC complies with the requirements of Act 162 as codified in the Hawaii Revised Statutes (HRS). On September 6, 2007, HECO, the Consumer Advocate and the DOD (the parties) executed and filed an agreement on most of the issues in HECO's 2007 test year rate case proceeding. In the settlement agreement, the parties agreed that the ECAC should continue in its present form for purposes of an interim rate increase and stated that they are continuing discussions with respect to the final design of the ECAC to be proposed for approval in the final D&O in this proceeding. On October 22, 2007 the PUC issued an interim D&O in HECO's 2007 test year rate case which reflected the continuation of HECO's ECAC for purposes of the interim increase, consistent with the agreement reached among the parties. The parties will file proposed findings of fact and conclusions of law on all issues in this proceeding, including the ECAC, and the schedule for that filing is being determined. The parties have agreed that their resolution of the ECAC issue will not affect their agreement regarding revenue requirements in the proceeding. Management cannot predict the ultimate effect of the required Act 162 analysis on the continuation of the Company's existing ECACs.

In an order issued on June 19, 2007, the PUC approved a procedural order for MECO's 2007 test year rate case and required MECO and the Consumer Advocate (the parties) to address an additional issue of whether MECO's ECAC complies with the requirements of Act 162 as codified in the HRS. In its direct testimony, the Consumer Advocate concluded that the ECAC's fixed efficiency factors are an effective means of sharing the operating and performance risks between MECO's ratepayers and shareholders and that MECO's ECAC provides a fair sharing of the risks of fuel cost changes between MECO and its ratepayers in a manner that preserves the financial integrity of MECO without the need for frequent rate filings. On December 7, 2007, the parties filed a stipulated settlement letter for this proceeding in which the parties agreed, among other things, that no further changes are required to MECO's ECAC in order to comply with the requirements of Act 162. On December 21, 2007 the PUC issued an interim D&O in MECO's 2007 test year rate case which reflected the continuation of MECO's ECAC for purposes of the interim increase, consistent with the agreement reached among the parties.

On April 23, 2007, the PUC issued an order denying HECO's proposal to recover $2.4 million, including revenue taxes, of distributed generation fuel and trucking and low sulfur fuel oil (LFSO) trucking costs since January 1, 2006 through the reconciliation process for the ECAC. However, the PUC allowed HECO to establish and implement a new and separate interim surcharge to recover its additional DG and LFSO costs on a going forward basis. HECO implemented an interim surcharge to recover such costs incurred from May 1, 2007.

**HELCO power situation.** In 1991, HELCO began planning to meet increased electric generation demand forecast for 1994. It planned to install at its Keahole power plant two 20 MW combustion turbines (CT-4 and CT-5), followed by an 18 MW heat recovery steam generator (ST-7), at which time these units would be converted to a 56 MW (net) dual-train combined-cycle unit. In January 1994, the PUC approved expenditures for CT-4. In 1995, the PUC allowed HELCO to pursue construction of and commit expenditures for CT-5 and ST-7, but noted that such costs are not to be included in rate base until the project is installed and "is used and useful for utility purposes." There were a number of environmental and other permitting challenges to construction of CT-4, CT-5 and ST-7, resulting in significant delays in the installation and operation of these generating units. However, in 2003, the parties opposing the plant expansion project (other than Waimana Enterprises, Inc. (Waimana), which did not participate in the settlement discussions and opposed the settlement) entered into a settlement agreement with HELCO and several Hawaii regulatory agencies, intended in part to permit HELCO to complete CT-4 and CT-5 (Settlement Agreement). The Settlement Agreement required HELCO to undertake a number of actions including expediting efforts to obtain the permits and approvals necessary for installation of ST-7 with selective catalytic reduction emissions control equipment, assisting the Department of Hawaiian Home Lands in installing solar water heating in its housing projects, supporting the Keahole Defense Coalition's participation in certain PUC cases, and cooperating with neighbors and community groups (including adding a Hot Line service). While certain of these actions have been completed, and required payments to other parties to the settlement agreement were timely made, a number of these actions are ongoing.

As a result of the final resolution of various proceedings due primarily to the Settlement Agreement, CT-4 and CT-5 became operational in mid-2004, there are no pending lawsuits involving the project, and work on ST-7 is proceeding. Noise mitigation equipment has been installed on CT-4 and CT-5 and additional noise mitigation work is ongoing to ensure compliance with the night-time noise standard applicable to the plant. Currently, HELCO can operate CT-4 and CT-5 as required to meet its system needs. Construction of a noise barrier was substantially completed in December 2007, and installation of other noise mitigation measures are planned. Subsequent testing will determine whether current restrictions on the operations of these units may be eliminated or eased.

HELCO's plans for ST-7 are progressing. In November 2003, HELCO filed a boundary amendment petition (to reclassify the Keahole plant site from conservation land use to urban land use) with the State of Hawaii Land Use Commission, which boundary amendment was approved in October 2005. In May 2006, HELCO obtained the County of Hawaii rezoning to a "General Industrial" classification, and in June 2006, received approval for a covered source permit amendment to include selective catalytic reduction with the installation of ST-7. Management believes that any other required permits will be obtained and anticipates an in-service date for ST-7 in mid-2009. HELCO has commenced engineering, design and certain construction work for ST-7. HELCO's current cost estimate for ST-7 is approximately $92 million, of which approximately $9 million has been incurred through December 31, 2007. HELCO has made about $32 million in additional commitments for materials, equipment and outside services, a substantial portion of which are subject to cancellation charges.

*CT-4 and CT-5 costs incurred and allowed.* HELCO's capitalized costs incurred in its efforts to put CT-4 and CT-5 into service and to support existing units (excluding costs for pre-air permit facilities) amounted to approximately $110 million. The $110 million of costs was reclassified from construction in progress to plant and equipment in 2004 ($103 million) and 2005 ($7 million) and depreciated beginning January 1, 2005 and 2006, respectively, and HELCO sought recovery of these costs as part of its 2006 test year rate case.

In March 2007, HELCO and the Consumer Advocate reached a settlement of the issues in the HELCO 2006 rate case proceeding, subject to PUC approval. Under the settlement, HELCO agreed to write-off approximately $12 million of plant-in-service costs, net of average accumulated depreciation, relating to CT-4 and CT-5, resulting in an after-tax charge to net income in the first quarter of 2007 of approximately $7 million (included in "Other, net" under "Other income (loss)" on HECO's consolidated statement of income).

In April 2007, the PUC issued an interim D&O granting HELCO a 7.58% increase in rates, which reflects the settlement agreement reached between HELCO and the Consumer Advocate, including the agreement to write-off a portion of CT-4 and CT-5 costs. However, the interim order does not commit the PUC to accept any of the amounts in the interim increase in its final order. If it becomes probable that the PUC, in its final order, will disallow additional costs incurred for CT-4 and CT-5 for ratemaking purposes, HELCO will be required to record an additional write-off.

**East Oahu Transmission Project (EOTP).** HECO transmits bulk power to the Honolulu/East Oahu area over two major transmission corridors (Northern and Southern). HECO had planned to construct a partial underground/partial overhead 138 kilovolt (kV) line from the Kamoku substation to the Pukele substation, which serves approximately 16% of Oahu's electrical load, including Waikiki, in order to close the gap between the Southern and Northern corridors and provide a third transmission line to the Pukele substation. In total, this additional transmission capacity would benefit an area that comprises approximately 56% of the power demand on Oahu. However, in June 2002, an application for a permit which would have allowed construction in the originally planned route through conservation district lands was denied.

HECO continued to believe that the proposed reliability project (the East Oahu Transmission Project) was needed and, in December 2003, filed an application with the PUC requesting approval to commit funds (currently estimated at $74 million; see costs incurred below) for a revised EOTP using a 46 kV system. In March 2004, the PUC granted intervener status to an environmental organization and three elected officials (collectively treated as one party), and a more limited participant status to four community organizations. The environmental review process for the revised EOTP was completed and the PUC issued a Finding of No Significant Impact in April 2005.

In written testimony filed in June 2005, the consultant for the Consumer Advocate contended that HECO should always have planned for a project using only the 46 kV system and recommended that HECO be required to expense the $12 million incurred prior to the denial in 2002 of the approval necessary for the partial underground/partial overhead 138 kV line, and the related allowance for funds used during construction (AFUDC) of $5 million. In rebuttal testimony filed in August 2005, HECO contested the consultant's recommendation, emphasizing that the originally proposed 138 kV line would have been a more comprehensive and robust solution to the transmission concerns the project addressed. The PUC held an evidentiary hearing on HECO's application in November 2005, and post-hearing briefing was completed in March 2006. Just prior to the November 2005 evidentiary hearing, the PUC approved that part of a stipulation between HECO and the Consumer Advocate providing that (i) this proceeding should determine whether HECO should be given approval to expend funds for the EOTP, but with the understanding that no part of the EOTP costs may be recovered from ratepayers unless and until the PUC grants HECO recovery in a rate case (which is consistent with other projects) and (ii) the issue as to whether the pre-2003 planning and permitting costs, and related AFUDC, should be included in the project costs is reserved to, and may be raised in, the next HECO rate case (or other proceeding) in which HECO seeks approval to recover the EOTP costs. In October 2007, the PUC issued a final D&O approving HECO's request to expend funds for a revised EOTP using a 46 kV system, but stating that the issue of recovery of the EOTP costs would be determined in a subsequent rate case, after the project is installed and in service.

Subject to obtaining other construction permits, HECO plans to construct the revised project, none of which is in conservation district lands, in two phases. The first phase is currently projected to be completed in 2010 and the projected completion date of the second phase is being evaluated.

As of December 31, 2007, the accumulated costs recorded for the EOTP amounted to $33 million, including (i) $12 million of planning and permitting costs incurred prior to 2003, (ii) $6 million of planning and permitting costs incurred after 2002 and (iii) $15 million for AFUDC. Management believes no adjustment to project costs is required as of December 31, 2007. However, if it becomes probable that the PUC will disallow some or all of the incurred costs for rate-making purposes, HECO may be required to write off a material portion or all of the project costs incurred in its efforts to put the project into service whether or not it is completed.

**Environmental regulation.** HECO and its subsidiaries are subject to environmental laws and regulations that regulate the operation of existing facilities, the construction and operation of new facilities and the proper cleanup and disposal of hazardous waste and toxic substances.

HECO, HELCO and MECO, like other utilities, periodically identify petroleum or other chemical releases into the environment associated with current operations and report and take action on these releases when and as required by applicable law and regulations. Except as otherwise disclosed herein, the Company believes the costs of responding to releases identified to date will not have a material adverse effect, individually or in the aggregate, on its consolidated financial statements.

Additionally, current environmental laws may require HECO and its subsidiaries to investigate whether releases from historical operations may have contributed to environmental impacts, and, where appropriate, respond to such releases, even if they were not inconsistent with law or standard industrial practices prevailing at the time when they occurred. Such releases may involve area-wide impacts contributed to by multiple potentially responsible parties.

*Honolulu Harbor investigation.* In 1995, the Department of Health of the State of Hawaii (DOH) issued letters indicating that it had identified a number of parties, including HECO, who appeared to be potentially responsible for historical subsurface petroleum contamination and/or operated their facilities upon petroleum-contaminated land at or near Honolulu Harbor in the Iwilei district of Honolulu. Certain of the identified parties formed a work group to determine the nature and extent of any contamination and appropriate response actions, as well as to identify additional potentially responsible parties (PRPs). The U.S. Environmental Protection Agency (EPA) became involved in the investigation in June 2000. Later in 2000, the DOH issued notices to additional PRPs. The parties in the work group and some of the new PRPs (collectively, the Participating Parties) entered into a joint defense agreement and signed a voluntary response agreement with the DOH. The Participating Parties agreed to fund investigative and remediation work using an interim cost allocation method (subject to a final allocation) and have organized a limited liability company to perform the work.

In 2001, management developed and expensed a preliminary estimate of HECO's share of costs for continuing investigative work, remedial activities and monitoring at the Iwilei Unit of $1.1 million. Since 2001, subsurface investigation and assessment have been conducted and several preliminary oil removal tasks have been performed at the Iwilei Unit in accordance with notices of interest issued by the EPA and the DOH.

In 2003, HECO and other Participating Parties with active operations in the Iwilei area investigated their operations to evaluate whether their facilities were active sources of petroleum contamination in the area. HECO's investigation concluded that its facilities were not then releasing petroleum. Routine maintenance and inspections of HECO facilities since then confirm that they are not currently releasing petroleum.

During 2006 and the beginning of 2007, the PRPs developed analyses of various remedial alternatives for two of the four remedial subunits of the Iwilei Unit. The DOH will use the analyses to make a final determination of which remedial alternatives the PRPs will be required to implement. The DOH is scheduled to complete the final remediation determinations for all remedial subunits of the Iwilei Unit by the end of the first quarter of 2008. HECO management developed an estimate of HECO's share of the costs associated with implementing the PRP recommended remedial approaches for the two subunits covered by the analyses of $1.2 million, which was expensed in 2006. Subsequently, based on the estimated costs for the remaining two subunits, as well as updated estimates for total remediation costs, HECO management expensed an additional $0.6 million in the third quarter of 2007.

As of December 31, 2007, the remaining accrual (amounts expensed less amounts expended) related to the Honolulu Harbor investigation was $1.8 million. Because (1) the full scope of additional investigative work, remedial activities and monitoring remain to be determined, (2) the final cost allocation method among the PRPs has not yet been established and (3) management cannot estimate the costs to be incurred (if any) for the sites other than the Iwilei Unit (such as its Honolulu power plant, which is located in the "Downtown" unit of the Honolulu Harbor site), the cost estimate may be subject to significant change and additional material investigative and remedial costs may be incurred.

*Regional Haze Rule amendments*. In June 2005, the EPA finalized amendments to the July 1999 Regional Haze Rule that require emission controls known as best available retrofit technology (BART) for industrial facilities emitting air pollutants that reduce visibility in National Parks by causing or contributing to regional haze. States were to adopt BART implementation plans and schedules in accordance with the amended regional haze rule by December 2007. After Hawaii adopts its plan, which it has not done to date, HECO, HELCO and MECO will evaluate the plan's impacts, if any. If any of the utilities' generating units are ultimately required to install post-combustion control technologies to meet BART emission limits, the resulting capital and operation and maintenance costs could be significant.

*Clean Water Act*. Section 316(b) of the federal Clean Water Act requires that the EPA ensure that existing power plant cooling water intake structures reflect the best technology available for minimizing adverse environmental impacts. Effective September 9, 2004, the EPA issued a rule, which established location and technology-based design, construction and capacity standards for existing cooling water intake structures. These standards applied to HECO's Kahe, Waiau and Honolulu generating stations, unless the utility could demonstrate that at each facility implementation of these standards would result in costs either significantly higher than projected costs the EPA considered in establishing the standards for the facility (cost-cost test) or significantly greater than the benefits of meeting the standards (cost-benefit test). In either case, the EPA would then make a case-by-case determination of an appropriate performance standard. The regulation also would have allowed restoration of aquatic organism populations in lieu of meeting the standards. The rule required covered facilities to demonstrate compliance by March 2008. HECO had retained a consultant that was developing a cost effective compliance strategy and a preliminary assessment of technologies and operational measures under the rule.

On January 25, 2007, the U.S. Circuit Court for the Second Circuit issued a decision in Riverkeeper, Inc. v. EPA that remanded for further consideration and proceedings significant portions of the rule and found other portions of the rule to be impermissible. In particular, the court determined that restoration and the cost-benefit test provisions of the rule were impermissible under the Clean Water Act. It also remanded the best technology available determination to permit the EPA to provide a reasoned explanation for its decision or a new determination. It remanded the cost-cost test for the EPA's further consideration based on the best technology available determination and to afford adequate notice. Although the EPA has decided not to request the U.S. Supreme Court to review the Court of Appeal's decision, several utilities have sought Supreme Court review. If the Court of Appeal's decision stands, the ruling reduces the compliance options available to HECO. In addition, the EPA has not issued a schedule for rulemaking, which would be necessary to comply with the Court's decision. On July 9, 2007, the EPA formally suspended the rule. In the suspension announcement, the EPA provided guidance to federal and state permit writers that they should use their "best professional judgment" in determining permit conditions regarding cooling water intake requirements at existing power plants. Currently, this guidance does not affect the HECO facilities subject to the cooling water intake requirements because none of the facilities are subject to permit renewal until mid-2009. Due to the uncertainties raised by the Court's decision as well as the need for further rulemaking by the EPA, management is unable to predict which compliance options, some of which could entail significant capital expenditures to implement, will be applicable to its facilities.

**Collective bargaining agreements.** As of December 31, 2007, approximately 58% of the Company's employees are members of the International Brotherhood of Electrical Workers, AFL-CIO, Local 1260, Unit 8, which is the only union representing employees of the Company. Four-year collective bargaining and benefit agreements with the union covered a term from November 1, 2003 to October 31, 2007 and have been extended to March 3, 2008. These collective bargaining agreements provided for non-compounded wage increases (3% on November 1, 2003; 1.5% on November 1, 2004, May 1, 2005, November 1, 2005 and May 1, 2006; and 3% on November 1, 2006). Negotiations for new agreements began in the third quarter of 2007 and are continuing.

**Limited insurance.** HECO and its subsidiaries purchase insurance coverages to protect themselves against loss of or damage to their properties and against claims made by third-parties and employees. However, the protection provided by such insurance is limited in significant respects and, in some instances, there is no coverage. HECO, HELCO and MECO's overhead and underground transmission and distribution systems (with the exception of substation buildings and contents) have a replacement value roughly estimated at $4 billion and are uninsured. Similarly, HECO, HELCO and MECO have no business interruption insurance. If a hurricane or other uninsured catastrophic natural disaster were to occur, and if the PUC were not to allow the utilities to recover from ratepayers restoration costs and revenues lost from business interruption, their results of operations and financial condition could be materially adversely impacted. Also, certain insurance has substantial "deductibles", limits on the maximum amounts that may be recovered and exclusions or limitations of coverage for claims related to certain perils. If a series of losses occurred, such as from a series of lawsuits in the ordinary course of business, each of which were subject to the deductible amount, or if the maximum limit of the available insurance were substantially exceeded, HECO, HELCO and MECO could incur losses in amounts that would have a material adverse effect on its results of operations and financial condition.

## 12. Regulatory restrictions on distributions to parent

As of December 31, 2007, net assets (assets less liabilities and preferred stock) of approximately $495 million were not available for transfer to HEI in the form of dividends, loans or advances without regulatory approval.

## 13. Related-party transactions

HEI charged HECO and its subsidiaries $3.4 million, $3.4 million and $3.3 million for general management and administrative services in 2007, 2006 and 2005, respectively. The amounts charged by HEI to its subsidiaries are allocated primarily on the basis of actual labor hours expended in providing such services.

HECO's borrowings from HEI fluctuate during the year, and totaled nil at December 31, 2007 and 2006. The interest charged on short-term borrowings from HEI is based on the rate HEI pays on its commercial paper borrowings, provided HEI's commercial paper rating is equal to or better than HECO's rating. If HEI's commercial paper rating falls below HECO's, or if HEI has no commercial paper borrowings, interest is based on HECO's short-term external borrowing rate, or quoted rates from the Wall Street Journal for 30-day dealer-placed commercial paper.

Interest charged by HEI to HECO totaled nil, nil and $0.4 million in 2007, 2006 and 2005, respectively.

## 14. Significant group concentrations of credit risk

HECO and its utility subsidiaries are regulated operating electric public utilities engaged in the generation, purchase, transmission, distribution and sale of electricity on the islands of Oahu, Hawaii, Maui, Lanai and Molokai in the State of Hawaii. HECO and its utility subsidiaries provide the only electric public utility service on the islands they serve. HECO and its utility subsidiaries grant credit to customers, all of whom reside or conduct business in the State of Hawaii.

## 15. Fair value of financial instruments

Fair value estimates are based on the price that would be received to sell an asset, or paid upon the transfer of a liability, in an orderly transaction between market participants at the measurement date. The fair value estimates are generally determined based on assumptions that market participants would use in pricing the asset or liability and are based on market data obtained from independent sources. However, in certain cases, the Company uses its own assumptions about market participant assumptions developed on the best information available in the circumstances. These valuations are estimates at a specific point in time, based on relevant market information, information about the financial instrument and judgments regarding future expected loss experience, economic conditions, risk characteristics of various financial instruments and other factors. These estimates do not reflect any premium or discount that could result if the Company were to sell its entire holdings of a particular financial instrument at one time. Because no market exists for a portion of the Company's financial instruments, fair value estimates cannot be determined with precision. Changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the estimates. Fair value estimates are provided for certain financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. In addition, the tax ramifications related to the realization of the unrealized gains and losses could have a significant effect on fair value estimates and have not been considered.

The Company used the following methods and assumptions to estimate the fair value of each applicable class of financial instruments for which it is practicable to estimate that value:

**Cash and equivalents and short-term borrowings**

*The carrying amount approximated fair value because of the short maturity of these instruments.*

**Long-term debt**

Fair value was obtained from a third party financial services provider based on the current rates offered for debt of the same or similar remaining maturities.

**Off-balance sheet financial instruments**

The fair values of off-balance sheet financial instruments were estimated based on quoted market prices of comparable instruments.

The estimated fair values of the financial instruments held or issued by the Company were as follows:

| December 31 | 2007 | | 2006 | |
|---|---|---|---|---|
| (in thousands) | Carrying Amount | Estimated fair value | Carrying amount | Estimated fair value |
| **Financial assets:** | | | | |
| Cash and equivalents | $ 4,678 | $ 4,678 | $ 3,859 | $ 3,859 |
| **Financial liabilities:** | | | | |
| Short-term borrowings from nonaffiliates | 28,791 | 28,791 | 113,107 | 113,107 |
| Long-term debt, net, including amounts due within one year | 885,099 | 904,092 | 766,185 | 800,975 |
| **Off-balance sheet item:** | | | | |
| HECO-obligated preferred securities of trust subsidiary | 50,000 | 46,200 | 50,000 | 50,800 |

## 16. Sale of non-electric utility property

In August 2007, HECO sold land and a building that executives and management had been using as a recreational facility. The sale of the non-electric utility property resulted in an after-tax gain in the third quarter of 2007 of approximately $2.9 million.

## 17. Consolidated quarterly financial information *(unaudited)*

Selected quarterly consolidated financial information of the Company for 2007 and 2006 follows:

| 2007 (in thousands) | Quarters ended March 31 | June 30 | Sept. 30 | Dec. 31 | Year ended Dec. 31 |
|---|---|---|---|---|---|
| Operating revenues (1),(2) | $446,797 | $491,249 | $561,720 | $597,192 | $2,096,958 |
| Operating income (1),(2) | 19,503 | 21,222 | 20,736 | 38,814 | 100,275 |
| Net income for common stock (1),(2),(3) | 453 | 10,650 | 12,875 | 28,178 | 52,156 |

| 2006 (in thousands) | Quarters ended March 31 | June 30 | Sept. 30 | Dec. 31 | Year ended Dec. 31 |
|---|---|---|---|---|---|
| Operating revenues (4),(5) | $473,971 | $503,350 | $568,236 | $504,855 | $2,050,412 |
| Operating income (4),(5) | 31,562 | 28,502 | 32,736 | 24,355 | 117,155 |
| Net income for common stock (4),(5) | 20,988 | 17,286 | 23,666 | 13,007 | 74,947 |

Note: HEI owns all of HECO's common stock, therefore per share data is not meaningful.

(1) For 2007, amounts include interim rate relief for HECO (2005 test year; 2007 test year since October 22, 2007), HELCO (2006 test year since April 5, 2007) and MECO (2007 test year since December 21, 2007).

(2) The third quarter of 2007 includes a $9 million, net of tax benefits, reserve accrued for the potential refund (with interest) of a portion of HECO's 2005 test year interim rate increase.

(3) The first quarter of 2007 includes a $7 million, net of tax benefits, write-off of plant in service costs at HELCO as part of a settlement in HELCO's 2006 test year rate case.

(4) The fourth quarter of 2006 includes an adjustment for quarterly rate schedule tariff reconciliation that relates to prior quarters.

(5) For 2006, amounts include interim rate relief for HECO (2005 test year).

## *Explanation of Reclassifications and Eliminations on Consolidating Schedules*

**Hawaiian Electric Company, Inc. and Subsidiaries as of and for the year ended December 31, 2007**

[1] Eliminations of intercompany receivables and payables and other intercompany transactions.

[2] Elimination of investment in subsidiaries, carried at equity.

[3] Reclassification of preferred stock dividends of Hawaii Electric Light Company, Inc. and Maui Electric Company, Limited for financial statement presentation.

## Consolidating Schedule – Income (Loss) Information

**Hawaiian Electric Company, Inc. and Subsidiaries**

| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Reclassifications and Eliminations | | HECO Consolidated |
|---|---|---|---|---|---|---|---|---|
| | Year ended December 31, 2007 | | | | | | | |
| Operating revenues | $1,385,137 | 361,411 | 350,410 | -- | -- | -- | | $2,096,958 |
| **Operating expenses** | | | | | | | | |
| Fuel oil | 525,555 | 74,965 | 173,599 | -- | -- | -- | | 774,119 |
| Purchased power | 368,766 | 134,919 | 33,275 | -- | -- | -- | | 536,960 |
| Other operation | 148,857 | 32,960 | 32,230 | -- | -- | -- | | 214,047 |
| *Maintenance* | 62,208 | 20,700 | 22,835 | -- | -- | -- | | 105,743 |
| Depreciation | 78,972 | 30,094 | 28,015 | -- | -- | -- | | 137,081 |
| Taxes, other than income taxes | 129,015 | 33,274 | 32,318 | -- | -- | -- | | 194,607 |
| *Income taxes* | 17,648 | 9,534 | 6,944 | -- | -- | -- | | 34,126 |
| | 1,331,021 | 336,446 | 329,216 | -- | -- | -- | | 1,996,683 |
| **Operating income** | 54,116 | 24,965 | 21,194 | -- | -- | -- | | 100,275 |
| **Other income** | | | | | | | | |
| Allowance for equity funds used during construction | 4,404 | 461 | 354 | -- | -- | -- | | 5,219 |
| Equity in earnings of subsidiaries | 19,907 | -- | -- | -- | -- | (19,907) | [2] | -- |
| Other, net | 7,927 | (6,299) | 349 | (83) | (47) | (2,474) | [1] | (627) |
| | 32,238 | (5,838) | 703 | (83) | (47) | (22,381) | | 4,592 |
| **Income before interest and other charges** | 86,354 | 19,127 | 21,897 | (83) | (47) | (22,381) | | 104,867 |
| **Interest and other charges** | | | | | | | | |
| Interest on long-term debt | 29,310 | 7,625 | 9,029 | -- | -- | -- | | 45,964 |
| Amortization of net bond premium and expense | 1,539 | 419 | 482 | -- | -- | -- | | 2,440 |
| Other interest charges | 4,415 | 2,531 | 392 | -- | -- | (2,474) | [1] | 4,864 |
| Allowance for borrowed funds used during construction | (2,146) | (234) | (172) | -- | -- | -- | | (2,552) |
| Preferred stock dividends of subsidiaries | -- | -- | -- | -- | -- | 915 | [3] | 915 |
| | 33,118 | 10,341 | 9,731 | -- | -- | (1,559) | | 51,631 |
| ***Income before preferred stock dividends of HECO*** | 53,236 | 8,786 | 12,166 | (83) | (47) | (20,822) | | 53,236 |
| Preferred stock dividends of HECO | 1,080 | 534 | 381 | -- | -- | (915) | [3] | 1,080 |
| **Net income for common stock** | $ 52,156 | 8,252 | 11,785 | (83) | (47) | (19,907) | | $ 52,156 |

## Consolidating Schedule - Retained Earnings Information

**Hawaiian Electric Company, Inc. and Subsidiaries**

| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Reclassifications and Eliminations | | HECO Consolidated |
|---|---|---|---|---|---|---|---|---|
| | Year ended December 31, 2007 | | | | | | | |
| Retained earnings, beginning of period | $700,252 | 92,836 | 111,536 | (516) | -- | (203,856) | [2] | $700,252 |
| Net income for common stock | 52,156 | 8,252 | 11,785 | (83) | (47) | (19,907) | [2] | 52,156 |
| Adjustment to initially apply FIN 48 | (620) | (44) | (33) | -- | -- | 77 | [2] | (620) |
| Common stock dividends | (27,084) | -- | (9,900) | -- | -- | 9,900 | [2] | (27,084) |
| Retained earnings, end of period | $724,704 | 101,044 | 113,388 | (599) | (47) | (213,786) | | $724,704 |

See accompanying "Report of Independent Registered Public Accounting Firm."

## Consolidating Schedule – Balance Sheet Information

Hawaiian Electric Company, Inc. and Subsidiaries

| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Reclassifications and Eliminations | HECO Consolidated |
|---|---|---|---|---|---|---|---|
| | December 31, 2007 | | | | | | |
| **Assets** | | | | | | | |
| Utility plant, at cost | | | | | | | |
| Land | $ 28,833 | 4,982 | 4,346 | -- | -- | -- | $ 38,161 |
| Plant and equipment | 2,504,389 | 830,237 | 796,600 | -- | -- | -- | 4,131,226 |
| Less accumulated depreciation | (988,732) | (324,517) | (333,864) | -- | -- | -- | (1,647,113) |
| Plant acquisition adjustment, net | -- | -- | 41 | -- | -- | -- | 41 |
| Construction in progress | 114,227 | 26,262 | 10,690 | -- | -- | -- | 151,179 |
| Net utility plant | 1,658,717 | 536,964 | 477,813 | -- | -- | -- | 2,673,494 |
| Investment in wholly owned subsidiaries, at equity | 410,911 | -- | -- | -- | -- | (410,911) [2] | -- |
| Current assets | | | | | | | |
| Cash and equivalents | 203 | 3,069 | 773 | 198 | 435 | -- | 4,678 |
| Advances to affiliates | 36,600 | -- | 2,000 | -- | -- | (38,600) [1] | -- |
| Customer accounts receivable, net | 98,129 | 26,554 | 21,429 | -- | -- | -- | 146,112 |
| Accrued unbilled revenues, net | 82,550 | 16,795 | 14,929 | -- | -- | -- | 114,274 |
| Other accounts receivable, net | 6,657 | 2,481 | 3,025 | -- | -- | (5,248) [1] | 6,915 |
| Fuel oil stock, at average cost | 57,289 | 12,494 | 22,088 | -- | -- | -- | 91,871 |
| Materials & supplies, at average cost | 15,723 | 4,404 | 14,131 | -- | -- | -- | 34,258 |
| Prepayments and other | 6,946 | 1,239 | 1,305 | -- | -- | -- | 9,490 |
| Total current assets | 304,097 | 67,036 | 79,680 | 198 | 435 | (43,848) | 407,598 |
| Other long-term assets | | | | | | | |
| Regulatory assets | 209,034 | 40,663 | 35,293 | -- | -- | -- | 284,990 |
| Unamortized debt expense | 10,555 | 2,458 | 2,622 | -- | -- | -- | 15,635 |
| Other | 30,449 | 5,671 | 6,051 | -- | -- | -- | 42,171 |
| Total other long-term assets | 250,038 | 48,792 | 43,966 | -- | -- | -- | 342,796 |
| | $2,623,763 | 652,792 | 601,459 | 198 | 435 | (454,759) | $3,423,888 |
| **Capitalization and liabilities** | | | | | | | |
| Capitalization | | | | | | | |
| Common stock equity | $ 1,110,462 | 201,820 | 208,521 | 182 | 388 | (410,911) [2] | $ 1,110,462 |
| Cumulative preferred stock–not subject to mandatory redemption | 22,293 | 7,000 | 5,000 | -- | -- | -- | 34,293 |
| Long-term debt, net | 567,657 | 145,811 | 171,631 | -- | -- | -- | 885,099 |
| Total capitalization | 1,700,412 | 354,631 | 385,152 | 182 | 388 | (410,911) | 2,029,854 |
| Current liabilities | | | | | | | |
| Short-term borrowings-nonaffiliates | 28,791 | -- | -- | -- | -- | -- | 28,791 |
| Short-term borrowings-affiliate | 2,000 | 36,600 | -- | -- | -- | (38,600) [1] | -- |
| Accounts payable | 97,699 | 21,810 | 18,386 | -- | -- | -- | 137,895 |
| Interest and preferred dividends payable | 9,774 | 2,370 | 2,738 | -- | -- | (163) [1] | 14,719 |
| Taxes accrued | 119,032 | 35,380 | 35,225 | -- | -- | -- | 189,637 |
| Other | 41,792 | 9,835 | 11,194 | 16 | 47 | (5,085) [1] | 57,799 |
| Total current liabilities | 299,088 | 105,995 | 67,543 | 16 | 47 | (43,848) | 428,841 |
| Deferred credits and other liabilities | | | | | | | |
| Deferred income taxes | 130,573 | 17,791 | 13,749 | -- | -- | -- | 162,113 |
| Regulatory liabilities | 180,725 | 46,460 | 34,421 | -- | -- | -- | 261,606 |
| Unamortized tax credits | 32,664 | 12,941 | 12,814 | -- | -- | -- | 58,419 |
| Other | 103,876 | 51,972 | 27,470 | -- | -- | -- | 183,318 |
| Total deferred credits and other liabilities | 447,838 | 129,164 | 88,454 | -- | -- | -- | 665,456 |
| Contributions in aid of construction | 176,425 | 63,002 | 60,310 | -- | -- | -- | 299,737 |
| | $2,623,763 | 652,792 | 601,459 | 198 | 435 | (454,759) | $3,423,888 |

See accompanying "Report of Independent Registered Public Accounting Firm."

**Consolidating Schedule – Changes in Common Stock Equity Information**

**Hawaiian Electric Company, Inc. and Subsidiaries**

| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Reclassi-fications and elimina-tions | HECO consoli-dated |
|---|---|---|---|---|---|---|---|
| *Balance, December 31, 2006* | *958,203* | *175,099* | *192,231* | 265 | -- | *(367,595)* | *958,203* |
| Comprehensive income: | | | | | | | |
| Net income (loss) | 52,156 | 8,252 | 11,785 | (83) | (47) | (19,907) | 52,156 |
| Retirement benefit plans: | | | | | | | |
| Net gains arising during the period, net of taxes of $9,861 | 15,484 | 1,262 | 1,773 | -- | -- | (3,035) | 15,484 |
| Less: amortization of transition obligation, prior service credit and net losses recognized during the period in net periodic benefit cost, net of tax benefits of $5,001 | 7,854 | 1,104 | 903 | -- | -- | (2,007) | 7,854 |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory asset, net of taxes of $11,007 | (17,282) | (2,069) | (1,733) | -- | -- | 3,802 | (17,282) |
| Comprehensive income (loss) | 58,212 | 8,549 | 12,728 | (83) | (47) | (21,147) | 58,212 |
| Adjustment to initially apply a PUC interim D&O related to defined benefit retirement plans, net of taxes of $77,546 | 121,751 | 18,205 | 13,506 | -- | -- | (31,711) | 121,751 |
| Adjustment to initially apply FIN 48 | (620) | (33) | (44) | -- | -- | 77 | (620) |
| Common stock dividends | (27,084) | -- | (9,900) | -- | -- | 9,900 | (27,084) |
| Issuance of common stock | -- | -- | -- | -- | 435 | (435) | -- |
| Balance, December 31, 2007 | $1,110,462 | 201,820 | 208,521 | 182 | 388 | (410,911) | $1,110,462 |

See accompanying "Report of Independent Registered Public Accounting Firm."

## Consolidating Schedule - Cash Flows Information

Hawaiian Electric Company, Inc. and Subsidiaries

| | Year ended December 31, 2007 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Elimination addition to (deduction from) cash flows | | HECO Consolidated |
| **Cash flows from operating activities:** | | | | | | | | |
| Income before preferred stock dividends of HECO | $ 53,236 | 8,786 | 12,166 | (83) | (47) | (20,822) | [2] | $ 53,236 |
| Adjustments to reconcile income before preferred stock dividends of HECO to net cash provided by operating activities: | | | | | | | | |
| Equity in earnings | (20,008) | -- | -- | -- | -- | 19,907 | [2] | (101) |
| Common stock dividends received from subsidiaries | 10,001 | -- | -- | -- | -- | (9,900) | [2] | 101 |
| Depreciation of property, plant and equipment | 78,972 | 30,094 | 28,015 | -- | -- | -- | | 137,081 |
| Other amortization | 3,892 | 375 | 3,963 | -- | -- | -- | | 8,230 |
| Writedown of utility plant | -- | 11,701 | -- | -- | -- | | | 11,701 |
| Deferred income taxes | (18,748) | (6,280) | (6,860) | -- | -- | -- | | (31,888) |
| Tax credits, net | 1,070 | 288 | 634 | -- | -- | -- | | 1,992 |
| Allowance for equity funds used during construction | (4,404) | (461) | (354) | -- | -- | -- | | (5,219) |
| Changes in assets and liabilities: | | | | | | | | |
| Increase in accounts receivable | (19,664) | (3,710) | (4,297) | -- | -- | 4,591 | [1] | (23,080) |
| Increase in accrued unbilled revenues | (18,315) | (2,358) | (1,406) | -- | -- | -- | | (22,079) |
| Increase in fuel oil stock | (16,609) | (2,733) | (8,217) | -- | -- | -- | | (27,559) |
| Decrease (increase) in materials and supplies | (1,764) | 488 | (2,442) | -- | -- | -- | | (3,718) |
| Decrease (increase) in regulatory assets | 2,252 | (559) | (3,661) | -- | -- | -- | | (1,968) |
| Increase (decrease) in accounts payable | 36,027 | (762) | 118 | -- | -- | -- | | 35,383 |
| Increase in taxes accrued | 22,186 | 8,399 | 6,870 | -- | -- | -- | | 37,455 |
| Changes in other assets and liabilities | 11,485 | 7,100 | 2,061 | 6 | 47 | (4,591) | [2] | 16,108 |
| Net cash provided by (used in) operating activities | 119,609 | 50,368 | 26,590 | (77) | -- | (10,815) | | 185,675 |
| **Cash flows from investing activities:** | | | | | | | | |
| Capital expenditures | (129,045) | (52,554) | (28,222) | -- | -- | -- | | (209,821) |
| Contributions in aid of construction | 10,834 | 4,952 | 3,225 | -- | -- | -- | | 19,011 |
| Advances from (to) affiliates | 17,800 | -- | (2,000) | -- | -- | (15,800) | [1] | -- |
| Proceeds from sales of assets | 5,440 | -- | -- | -- | -- | -- | | 5,440 |
| Investment in consolidated subsidiary | (435) | -- | -- | -- | -- | 435 | [2] | -- |
| Net cash used in investing activities | (95,406) | (47,602) | (26,997) | -- | -- | (15,365) | | (185,370) |
| **Cash flows from financing activities:** | | | | | | | | |
| Common stock dividends | (27,084) | -- | (9,900) | -- | -- | 9,900 | [2] | (27,084) |
| Preferred stock dividends | (1,080) | (534) | (381) | -- | -- | 915 | [2] | (1,080) |
| Proceeds from issuance of long-term debt | 147,593 | 22,625 | 72,320 | -- | -- | -- | | 242,538 |
| Repayment of long term debt | (62,280) | (8,020) | (55,700) | -- | -- | -- | | (126,000) |
| *Proceeds from issuance of common stock* | -- | -- | -- | -- | 435 | (435) | [2] | -- |
| Net decrease in short-term borrowings from nonaffiliates and affiliate with original maturities of three months or less | (82,316) | (12,800) | (5,000) | -- | -- | 15,800 | [1] | (84,316) |
| Other | (1,161) | (1,706) | (677) | -- | -- | -- | | (3,544) |
| Net cash provided by (used in) financing activities | (26,328) | (435) | 662 | -- | 435 | 26,180 | | 514 |
| Net increase in cash and equivalents | (2,125) | 2,331 | 255 | (77) | 435 | -- | | 819 |
| Cash and equivalents, beginning of year | 2,328 | 738 | 518 | 275 | -- | -- | | 3,859 |
| Cash and equivalents, end of year | $ 203 | 3,069 | 773 | 198 | 435 | -- | | $ 4,678 |

See accompanying "Report of Independent Registered Public Accounting Firm."

# Hawaiian Electric Company, Inc. and Subsidiaries

## Consolidated Financial Statements as of December 31, 2008 and 2007 and for the years ended December 31, 2008, 2007 and 2006 and Consolidating Schedules as of and for the year ended December 31, 2008

(With Report of Independent Registered Public Accounting Firm Thereon and Annual Report of Management on Internal Control Over Financial Reporting and Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting)

**Annual Report of Management on Internal Control Over Financial Reporting**

The Board of Directors and Shareholder
Hawaiian Electric Company, Inc.:

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934, as amended. The Company's internal control system was designed to provide reasonable assurance to management and the Board of Directors regarding the preparation and fair presentation of its consolidated financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2008 based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2008.

KPMG LLP, an independent registered public accounting firm, has issued an audit report on the Company's internal control over financial reporting as of December 31, 2008. This report appears on page 2.

/s/ Richard M. Rosenblum
Richard M. Rosenblum
President and
Chief Executive Officer

/s/ Tayne S. Y. Sekimura
Tayne S. Y. Sekimura
Senior Vice President,
Finance & Administration
and Chief Financial Officer

/s/ Patsy H. Nanbu
Patsy H. Nanbu
Controller and
Chief Accounting Officer

February 20, 2009

KPMG

KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

## Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

The Board of Directors and Shareholder
Hawaiian Electric Company, Inc.:

We have audited Hawaiian Electric Company, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Hawaiian Electric Company, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying annual report of management on internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Hawaiian Electric Company, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets and statements of capitalization of Hawaiian Electric Company, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, retained earnings, changes in common stock equity, and cash flows for each of the years in the three-year period ended December 31, 2008, and our report dated February 20, 2009 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Honolulu, Hawaii
February 20, 2009

KPMG

KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholder
Hawaiian Electric Company, Inc.:

We have audited the accompanying consolidated balance sheets and consolidated statements of capitalization of Hawaiian Electric Company, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, retained earnings, changes in common stock equity, and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hawaiian Electric Company, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in Notes 1 and 7 to the consolidated financial statements, the Company adopted the provisions of FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes*, as of January 1, 2007.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated statements rather than to present the financial position, results of operations and cash flows of the individual companies. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Hawaiian Electric Company, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 20, 2009 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

KPMG LLP

Honolulu, Hawaii
February 20, 2009

## Consolidated Financial Statements

### Consolidated Statements of Income

**Hawaiian Electric Company, Inc. and Subsidiaries**

| Years ended December 31 | 2008 | 2007 | 2006 |
|---|---|---|---|
| (in thousands) | | | |
| Operating revenues | $2,853,639 | $2,096,958 | $2,050,412 |
| **Operating expenses** | | | |
| Fuel oil | 1,229,193 | 774,119 | 781,740 |
| Purchased power | 689,828 | 536,960 | 506,893 |
| Other operation | 243,249 | 214,047 | 186,449 |
| Maintenance | 101,624 | 105,743 | 90,217 |
| Depreciation | 141,678 | 137,081 | 130,164 |
| Taxes, other than income taxes | 261,823 | 194,607 | 190,413 |
| Income taxes | 56,307 | 34,126 | 47,381 |
| | 2,723,702 | 1,996,683 | 1,933,257 |
| **Operating income** | 129,937 | 100,275 | 117,155 |
| **Other income** | | | |
| Allowance for equity funds used during construction | 9,390 | 5,219 | 6,348 |
| Other, net | 5,659 | (627) | 3,123 |
| | 15,049 | 4,592 | 9,471 |
| **Income before interest and other charges** | 144,986 | 104,867 | 126,626 |
| **Interest and other charges** | | | |
| Interest on long-term debt | 47,302 | 45,964 | 43,109 |
| Amortization of net bond premium and expense | 2,530 | 2,440 | 2,198 |
| Other interest charges | 4,925 | 4,864 | 7,256 |
| Allowance for borrowed funds used during construction | (3,741) | (2,552) | (2,879) |
| Preferred stock dividends of subsidiaries | 915 | 915 | 915 |
| | 51,931 | 51,631 | 50,599 |
| **Income before preferred stock dividends of HECO** | 93,055 | 53,236 | 76,027 |
| Preferred stock dividends of HECO | 1,080 | 1,080 | 1,080 |
| Net income for common stock | $ 91,975 | $ 52,156 | $ 74,947 |

### Consolidated Statements of Retained Earnings

**Hawaiian Electric Company, Inc. and Subsidiaries**

| Years ended December 31 | 2008 | 2007 | 2006 |
|---|---|---|---|
| (in thousands) | | | |
| **Retained earnings, January 1** | $724,704 | $700,252 | $654,686 |
| Net income for common stock | 91,975 | 52,156 | 74,947 |
| Adjustment to initially apply FIN 48 | - | (620) | - |
| Common stock dividends | (14,089) | (27,084) | (29,381) |
| **Retained earnings, December 31** | $802,590 | $724,704 | $700,252 |

See accompanying "Notes to Consolidated Financial Statements."

## Consolidated Balance Sheets

### Hawaiian Electric Company, Inc. and Subsidiaries

| December 31<br>(in thousands) | 2008 | 2007 |
|---|---|---|
| **Assets** | | |
| **Utility plant, at cost** | | |
| Land | $ 42,541 | $ 38,161 |
| Plant and equipment | 4,277,499 | 4,131,226 |
| Less accumulated depreciation | (1,741,453) | (1,647,113) |
| Plant acquisition adjustment, net | – | 41 |
| Construction in progress | 266,628 | 151,179 |
| **Net utility plant** | 2,845,215 | 2,673,494 |
| **Current assets** | | |
| Cash and equivalents | 6,901 | 4,678 |
| Customer accounts receivable, net | 166,422 | 146,112 |
| Accrued unbilled revenues, net | 106,544 | 114,274 |
| Other accounts receivable, net | 7,918 | 6,915 |
| Fuel oil stock, at average cost | 77,715 | 91,871 |
| Materials and supplies, at average cost | 34,532 | 34,258 |
| Prepayments and other | 12,626 | 9,490 |
| **Total current assets** | 412,658 | 407,598 |
| **Other long-term assets** | | |
| Regulatory assets | 530,619 | 284,990 |
| Unamortized debt expense | 14,503 | 15,635 |
| Other | 53,114 | 42,171 |
| **Total other long-term assets** | 598,236 | 342,796 |
| | $3,856,109 | $3,423,888 |
| **Capitalization and liabilities** | | |
| **Capitalization** *(see Consolidated Statements of Capitalization)* | | |
| Common stock equity | $ 1,188,842 | $ 1,110,462 |
| Cumulative preferred stock, not subject to mandatory redemption | 34,293 | 34,293 |
| Long-term debt, net | 904,501 | 885,099 |
| **Total capitalization** | 2,127,636 | 2,029,854 |
| **Current liabilities** | | |
| Short-term borrowings-nonaffiliates | – | 28,791 |
| Short-term borrowings-affiliate | 41,550 | – |
| Accounts payable | 122,994 | 137,895 |
| Interest and preferred dividends payable | 15,397 | 14,719 |
| Taxes accrued | 220,046 | 189,637 |
| Other | 55,268 | 57,799 |
| **Total current liabilities** | 455,255 | 428,841 |
| **Deferred credits and other liabilities** | | |
| Deferred income taxes | 166,310 | 162,113 |
| Regulatory liabilities | 288,602 | 261,606 |
| Unamortized tax credits | 58,796 | 58,419 |
| Retirement benefits liability | 392,845 | 129,288 |
| Other | 54,949 | 54,030 |
| **Total deferred credits and other liabilities** | 961,502 | 665,456 |
| **Contributions in aid of construction** | 311,716 | 299,737 |
| | $3,856,109 | $3,423,888 |

See accompanying "Notes to Consolidated Financial Statements."

## Consolidated Statements of Capitalization

**Hawaiian Electric Company, Inc. and Subsidiaries**

| December 31<br>(dollars in thousands, except par value) | 2008 | 2007 | 2006 |
|---|---|---|---|
| **Common stock equity** | | | |
| *Common stock of $6 2/3 par value* | | | |
| Authorized: 50,000,000 shares. Outstanding: | | | |
| 2008, 2007 and 2006, 12,805,843 shares | $ 85,387 | $ 85,387 | $ 85,387 |
| Premium on capital stock | 299,214 | 299,214 | 299,214 |
| Retained earnings | 802,590 | 724,704 | 700,252 |
| Accumulated other comprehensive income (loss), net of income tax benefits: | | | |
| Retirement benefit plans | 1,651 | 1,157 | (126,650) |
| ***Common stock equity*** | 1,188,842 | 1,110,462 | 958,203 |

**Cumulative preferred stock**
**not subject to mandatory redemption**

Authorized: 5,000,000 shares of $20 par value
and 7,000,000 shares of $100 par value.
Outstanding: 2008 and 2007, 1,234,657 shares.

| Series<br>(dollars in thousands, except par value and shares outstanding) | Par Value | | Shares Outstanding December 31, 2008 and 2007 | 2008 | 2007 |
|---|---|---|---|---|---|
| C-4 1/4% | $ 20 | (HECO) | 150,000 | 3,000 | 3,000 |
| D-5% | 20 | (HECO) | 50,000 | 1,000 | 1,000 |
| E-5% | 20 | (HECO) | 150,000 | 3,000 | 3,000 |
| H-5 1/4% | 20 | (HECO) | 250,000 | 5,000 | 5,000 |
| I-5% | 20 | (HECO) | 89,657 | 1,793 | 1,793 |
| J-4 3/4% | 20 | (HECO) | 250,000 | 5,000 | 5,000 |
| K-4.65% | 20 | (HECO) | 175,000 | 3,500 | 3,500 |
| G-7 5/8% | 100 | (HELCO) | 70,000 | 7,000 | 7,000 |
| H-7 5/8% | 100 | (MECO) | 50,000 | 5,000 | 5,000 |
| | | | 1,234,657 | $ 34,293 | $ 34,293 |

(continued)

See accompanying "Notes to Consolidated Financial Statements."

## Consolidated Statements of Capitalization, *continued*

### *Hawaiian Electric Company, Inc. and Subsidiaries*

| December 31 (in thousands) | 2008 | 2007 |
|---|---|---|
| **Long-term debt** | | |
| Obligations to the State of Hawaii for the repayment of Special Purpose Revenue Bonds: | | |
| HECO, 4.60%, refunding series 2007B, due 2026 | $ 62,000 | $ 62,000 |
| HELCO, 4.60%, refunding series 2007B, due 2026 | 8,000 | 8,000 |
| MECO, 4.60%, refunding series 2007B, due 2026 | 55,000 | 55,000 |
| HECO, 4.65%, series 2007A, due 2037 | 100,000 | 100,000 |
| HELCO, 4.65%, series 2007A, due 2037 | 20,000 | 20,000 |
| MECO, 4.65%, series 2007A, due 2037 | 20,000 | 20,000 |
| HECO, 4.80%, refunding series 2005A, due 2025 | 40,000 | 40,000 |
| HELCO, 4.80%, refunding series 2005A, due 2025 | 5,000 | 5,000 |
| MECO, 4.80%, refunding series 2005A, due 2025 | 2,000 | 2,000 |
| HECO, 5.00%, refunding series 2003B, due 2022 | 40,000 | 40,000 |
| HELCO, 5.00%, refunding series 2003B, due 2022 | 12,000 | 12,000 |
| HELCO, 4.75%, refunding series 2003A, due 2020 | 14,000 | 14,000 |
| HECO, 5.10%, series 2002A, due 2032 | 40,000 | 40,000 |
| HECO, 5.70%, refunding series 2000, due 2020 | 46,000 | 46,000 |
| MECO, 5.70%, refunding series 2000, due 2020 | 20,000 | 20,000 |
| HECO, 6.15%, refunding series 1999D, due 2020 | 16,000 | 16,000 |
| HELCO, 6.15%, refunding series 1999D, due 2020 | 3,000 | 3,000 |
| MECO, 6.15%, refunding series 1999D, due 2020 | 1,000 | 1,000 |
| HECO, 6.20%, series 1999C, due 2029 | 35,000 | 35,000 |
| HECO, 5.75%, refunding series 1999B, due 2018 | 30,000 | 30,000 |
| HELCO, 5.75%, refunding series 1999B, due 2018 | 11,000 | 11,000 |
| MECO, 5.75%, refunding series 1999B, due 2018 | 9,000 | 9,000 |
| HELCO, 5.50%, refunding series 1999A, due 2014 | 11,400 | 11,400 |
| HECO, 4.95%, refunding series 1998A, due 2012 | 42,580 | 42,580 |
| HELCO, 4.95%, refunding series 1998A, due 2012 | 7,200 | 7,200 |
| MECO, 4.95%, refunding series 1998A, due 2012 | 7,720 | 7,720 |
| HECO, 5.65%, series 1997A, due 2027 | 50,000 | 50,000 |
| HELCO, 5.65%, series 1997A, due 2027 | 30,000 | 30,000 |
| MECO, 5.65%, series 1997A, due 2027 | 20,000 | 20,000 |
| HECO, 5.45%, series 1993, due 2023 | 50,000 | 50,000 |
| HELCO, 5.45%, series 1993, due 2023 | 20,000 | 20,000 |
| MECO, 5.45%, series 1993, due 2023 | 30,000 | 30,000 |
| | 857,900 | 857,900 |
| Less funds on deposit with trustee | 3,186 | 22,461 |
| Total obligations to the State of Hawaii | 854,714 | 835,439 |
| Other long-term debt – unsecured: | | |
| 6.50 %, series 2004, Junior subordinated deferrable interest debentures, due 2034 | 51,546 | 51,546 |
| Total long-term debt | 906,260 | 886,985 |
| Less unamortized discount | 1,759 | 1,886 |
| **Long-term debt, net** | 904,501 | 885,099 |
| **Total capitalization** | $2,127,636 | $2,029,854 |

See accompanying "Notes to Consolidated Financial Statements."

**Consolidated Statements of Changes in Common Stock Equity**

**Hawaiian Electric Company, Inc. and Subsidiaries**

| (in thousands) | Common stock Shares | Common stock Amount | Premium on capital stock | Retained earnings | Accumulated other comprehensive income (loss) | Total |
|---|---|---|---|---|---|---|
| **Balance, December 31, 2005** | **12,806** | **$85,387** | **$299,212** | **$654,686** | **$ (26)** | **$1,039,259** |
| Comprehensive income: | | | | | | |
| Net income | – | – | – | 74,947 | – | 74,947 |
| Minimum pension liability adjustment, net of taxes of $18 | – | – | – | – | 26 | 26 |
| Comprehensive income | – | – | – | 74,947 | 26 | 74,973 |
| Adjustment to initially apply SFAS No. 158, net of tax benefits of $80,666 | – | – | – | – | (126,650) | (126,650) |
| Common stock dividends | – | – | – | (29,381) | – | (29,381) |
| Other | – | – | 2 | – | – | 2 |
| **Balance, December 31, 2006** | **12,806** | **85,387** | **299,214** | **700,252** | **(126,650)** | **958,203** |
| Comprehensive income: | | | | | | |
| Net income | – | – | – | 52,156 | – | 52,156 |
| Retirement benefit plans: | | | | | | |
| Net gains arising during the period, net of taxes of $9,861 | – | – | – | – | 15,484 | 15,484 |
| Less: amortization of transition obligation, prior service credit and net losses recognized during the period in net periodic benefit cost, net of tax benefits of $5,001 | – | – | – | – | 7,854 | 7,854 |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory asset, net of taxes of $11,007 | – | – | – | – | (17,282) | (17,282) |
| Comprehensive income | – | – | – | 52,156 | 6,056 | 58,212 |
| Adjustment to initially apply a PUC interim D&O related to defined benefit retirement plans, net of taxes of $77,546 | – | – | – | – | 121,751 | 121,751 |
| Adjustment to initially apply FIN 48 | – | – | – | (620) | – | (620) |
| Common stock dividends | – | – | – | (27,084) | – | (27,084) |
| **Balance, December 31, 2007** | **12,806** | **85,387** | **299,214** | **724,704** | **1,157** | **1,110,462** |
| Comprehensive income: | | | | | | |
| Net income | – | – | – | 91,975 | – | 91,975 |
| Retirement benefit plans: | | | | | | |
| Net losses arising during the period, net of tax benefits of $100,141 | – | – | – | – | (157,226) | (157,226) |
| Less: amortization of transition obligation, prior service credit and net losses recognized during the period in net periodic benefit cost, net of tax benefits of $3,481 | – | – | – | | 5,464 | 5,464 |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory asset, net of taxes of $96,975 | – | – | – | – | 152,256 | 152,256 |
| Comprehensive income | – | – | – | 91,975 | 494 | 92,469 |
| Common stock dividends | – | – | – | (14,089) | – | (14,089) |
| **Balance, December 31, 2008** | **12,806** | **$85,387** | **$299,214** | **$802,590** | **$ 1,651** | **$1,188,842** |

See accompanying "Notes to Consolidated Financial Statements."

**Consolidated Statements of Cash Flows**

***Hawaiian Electric Company, Inc. and Subsidiaries***

| Years ended December 31<br>(in thousands) | 2008 | 2007 | 2006 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Income before preferred stock dividends of HECO | $ 93,055 | $ 53,236 | $ 76,027 |
| Adjustments to reconcile income before preferred stock dividends of HECO to net cash provided by operating activities: | | | |
| Depreciation of utility plant | 141,678 | 137,081 | 130,164 |
| Other amortization | 8,619 | 8,230 | 7,932 |
| *Writedown of utility plant* | - | *11,701* | - |
| Deferred income taxes | 3,882 | (31,888) | (9,671) |
| Tax credits, net | 1,470 | 1,992 | 3,810 |
| Allowance for equity funds used during construction | (9,390) | (5,219) | (6,348) |
| Changes in assets and liabilities: | | | |
| Decrease (increase) in accounts receivable | (21,313) | (23,080) | 8,709 |
| Decrease (increase) in accrued unbilled revenues | 7,730 | (22,079) | (874) |
| Decrease (increase) in fuel oil stock | 14,156 | (27,559) | 21,138 |
| Increase in materials and supplies | (274) | (3,718) | (3,566) |
| Increase in regulatory assets | (3,229) | (1,968) | (6,123) |
| Increase (decrease) in accounts payable | (14,901) | 35,383 | (19,689) |
| Changes in prepaid and accrued income and utility revenue taxes | 28,055 | 37,455 | 18,599 |
| Decrease in prepaid pension benefit cost | - | - | 20,064 |
| Other | (5,445) | 16,108 | (12,641) |
| **Net cash provided by operating activities** | 244,093 | 185,675 | 227,531 |
| **Cash flows from investing activities** | | | |
| Capital expenditures | (278,476) | (209,821) | (195,072) |
| Contributions in aid of construction | 17,319 | 19,011 | 19,707 |
| Other | 1,157 | 5,440 | 407 |
| **Net cash used in investing activities** | (260,000) | (185,370) | (174,958) |
| **Cash flows from financing activities** | | | |
| Common stock dividends | (14,089) | (27,084) | (29,381) |
| Preferred stock dividends | (1,080) | (1,080) | (1,080) |
| Proceeds from issuance of long-term debt | 19,275 | 242,538 | - |
| Repayment of long-term debt | - | (126,000) | - |
| *Net increase (decrease) in short-term borrowings* from nonaffiliates and affiliate with original maturities of three months or less | 12,759 | (84,316) | (23,058) |
| Other | 1,265 | (3,544) | 4,662 |
| **Net cash provided by (used in) financing activities** | 18,130 | 514 | (48,857) |
| Net increase in cash and equivalents | 2,223 | 819 | 3,716 |
| **Cash and equivalents, January 1** | 4,678 | 3,859 | 143 |
| **Cash and equivalents, December 31** | $ 6,901 | $ 4,678 | $ 3,859 |

See accompanying "Notes to Consolidated Financial Statements."

## Notes to Consolidated Financial Statements

## Hawaiian Electric Company, Inc. and Subsidiaries

### 1. Summary of significant accounting policies

**General**

Hawaiian Electric Company, Inc. (HECO) and its wholly-owned operating subsidiaries, Hawaii Electric Light Company, Inc. (HELCO) and Maui Electric Company, Limited (MECO), are electric public utilities in the business of generating, purchasing, transmitting, distributing and selling electric energy on all major islands in Hawaii other than Kauai, and are regulated by the Public Utilities Commission of the State of Hawaii (PUC). HECO also owns non-regulated subsidiaries: Renewable Hawaii, Inc. (RHI), which will invest in renewable energy projects, Uluwehiokama Biofuels Corp. (UBC), which was formed to own a new biodiesel refining plant to be built on the island of Maui and is intended to direct its profits into a trust to be created for the purpose of funding biofuels development in Hawaii, and HECO Capital Trust III, which is an unconsolidated financing entity.

**Basis of presentation**

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change include the amounts reported for property, plant and equipment; pension and other postretirement benefit obligations; contingencies and litigation; income taxes; regulatory assets and liabilities; revenues; and variable interest entities (VIEs).

**Consolidation**

The consolidated financial statements include the accounts of HECO and its subsidiaries (collectively, the Company), but exclude subsidiaries which are variable-interest entities of which the Company is not the primary beneficiary. Investments in companies over which the Company has the ability to exercise significant influence, but not control, are accounted for using the equity method. The Company is a wholly-owned subsidiary of Hawaiian Electric Industries, Inc. (HEI). All material intercompany accounts and transactions have been eliminated in consolidation.

See Note 3 for information regarding the application of Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46(R).

**Regulation by the Public Utilities Commission of the State of Hawaii (PUC)**

HECO, HELCO and MECO are regulated by the PUC and account for the effects of regulation under Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." As a result, the actions of regulators can affect the timing of recognition of revenues, expenses, assets and liabilities. Management believes its operations currently satisfy the SFAS No. 71 criteria. If events or circumstances should change so that those criteria are no longer satisfied, the Company expects that the regulatory assets would be charged to expense and the regulatory liabilities would be credited to income or refunded to ratepayers. In the event of unforeseen regulatory actions or other circumstances, however, management believes that a material adverse effect on the Company's results of operations and financial position may result if regulatory assets have to be charged to expense without an offsetting credit for regulatory liabilities or if regulatory liabilities are required to be refunded to ratepayers.

**Equity method**

Investments in up to 50%-owned affiliates over which the Company has the ability to exercise significant influence over the operating and financing policies and investments in unconsolidated subsidiaries (e.g. HECO Capital Trust III) are accounted for under the equity method, whereby the investment is carried at cost, plus (or minus) the Company's equity in undistributed earnings (or losses) and minus distributions since acquisition. Equity in earnings or losses is reflected in other income. Equity method investments are evaluated for other-than-temporary impairment.

**Utility plant**

Utility plant is reported at cost. Self-constructed plant includes engineering, supervision, administrative and general costs and an allowance for the cost of funds used during the construction period. These costs are recorded in construction in progress and are transferred to utility plant when construction is completed and the facilities are either placed in service or become useful for public utility purposes. Costs for betterments that make utility plant more useful, more efficient, of greater durability or of greater capacity are also capitalized. Upon the retirement or sale of electric utility plant, generally no gain or loss is recognized. The cost of the plant retired is charged to accumulated depreciation. Amounts collected from customers for cost of removal (expected to exceed salvage value in the future) are included in regulatory liabilities.

If a power purchase agreement (PPA) falls within the scope of Emerging Issues Task Force (EITF) Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease" and results in the classification of the agreement as a capital lease, the Company would recognize a capital asset and a lease obligation.

**Depreciation**

Depreciation is computed primarily using the straight-line method over the estimated lives of the assets being depreciated. Utility plant additions in the current year are depreciated beginning January 1 of the following year. Utility plant has lives ranging from 20 to 45 years for production plant, from 25 to 60 years for transmission and distribution plant and from 7 to 45 years for general plant. The composite annual depreciation rate, which includes a component for cost of removal, was 3.8% in 2008 and 2007 and 3.9% in 2006.

**Cash and equivalents**

The Company considers cash on hand, deposits in banks, money market accounts, certificates of deposit, short-term commercial paper and liquid investments (with original maturities of three months or less) to be cash and equivalents.

**Accounts receivable**

Accounts receivable are recorded at the invoiced amount. The Company generally assesses a late payment charge on balances unpaid from the previous month. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company adjusts its allowance on a monthly basis, based on its historical write-off experience. Account balances are charged off against the allowance after collection efforts have been exhausted and the potential for recovery is considered remote.

**Retirement benefits**

Pension and other postretirement benefit costs are charged primarily to expense and utility plant. Funding for the Company's qualified pension plan is based on actuarial assumptions adopted by the Pension Investment Committee administering the plan on the advice of an enrolled actuary. The participating employers contribute amounts to a master pension trust for the plan in accordance with the funding requirements of Employee Retirement Income Security Act of 1974, as amended (ERISA), including changes promulgated by the Pension Protection Act of 2006, and considering the deductibility of contributions under the Internal Revenue Code. The Company generally funds at least the net periodic pension cost as calculated using SFAS No. 87 "Employers' Accounting for Pensions" during the fiscal year, subject to limits and targeted funded status as determined with the consulting actuary. Under a pension tracking mechanism approved by the PUC on an interim basis, HECO generally will make contributions to the pension fund at the minimum level required under the law, until its pension asset (existing at the time of the PUC decision and determined based on the cumulative fund contributions in excess of the cumulative net periodic pension cost recognized) is reduced to zero, at which time HECO would fund the pension cost as specified in the pension tracking mechanism. HELCO and MECO will generally fund the net periodic pension cost. Future decisions in rate cases could further impact funding amounts.

Certain health care and/or life insurance benefits are provided to eligible retired employees and the employees' beneficiaries and covered dependents. The Company generally funds the net periodic postretirement benefit costs other than pensions as calculated using SFAS No. 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions" and the amortization of the regulatory asset for postretirement benefits other than pensions (OPEB), while maximizing the use of the most tax advantaged funding vehicles, subject to cash flow requirements and reviews of the funded status with the consulting actuary. The Company must fund OPEB costs as specified in the OPEB tracking mechanisms, which were approved by the PUC on an interim basis. Future decisions in rate cases could further impact funding amounts.

Effective December 31, 2006, the Company adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)," and recognized on its balance sheet the funded status of its defined benefit pension and other postretirement benefit plans, as adjusted by the impact of decisions of the PUC.

**Financing costs**

The Company uses the straight-line method to amortize long-term debt financing costs and premiums or discounts over the term of the related debt. Unamortized financing costs and premiums or discounts on long-term debt retired prior to maturity are classified as regulatory assets (costs and premiums) or liabilities (discounts) and are amortized on a straight-line basis over the remaining original term of the retired debt. The method and periods for amortizing financing costs, premiums and discounts, including the treatment of these items when long-term debt is retired prior to maturity, have been established by the PUC as part of the rate-making process.

The Company uses the straight-line method to amortize the fees and related costs paid to secure a firm commitment under its line-of-credit arrangements.

**Contributions in aid of construction**

The Company receives contributions from customers for special construction requirements. As directed by the PUC, contributions are amortized on a straight-line basis over 30 years as an offset against depreciation expense.

**Electric utility revenues**

Electric utility revenues are based on rates authorized by the PUC and include revenues applicable to energy consumed in the accounting period but not yet billed to the customers. Revenues related to the sale of energy are generally recorded when service is rendered or energy is delivered to customers. However, the determination of the energy sales to individual customers for billing purposes is based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each month, amounts of energy delivered to customers since the date of the last meter reading are estimated and the corresponding unbilled revenue is estimated. This unbilled revenue is estimated each month based on the meter readings in the beginning of the following month, monthly generation volumes, estimated customer usage by account, line losses and applicable customer rates based on historical values and current rate schedules. As of December 31, 2008, customer accounts receivable include unbilled energy revenues of $107 million on a base of annual revenue of $2.9 billion. Revenue amounts recorded pursuant to a PUC interim order are subject to refund, with interest, pending a final order.

The rate schedules of the Company include energy cost adjustment clauses (ECACs) under which electric rates are adjusted for changes in the weighted-average price paid for fuel oil and certain components of purchased power, and the relative amounts of company-generated power and purchased power. The ECACs also include a provision requiring a quarterly reconciliation of the amounts collected through the ECACs. See "Energy cost adjustment clauses" in Note 11 for a discussion of the ECACs and Act 162 of the 2006 Hawaii State Legislature.

The Company's operating revenues include amounts for various revenue taxes. Revenue taxes are generally recorded as an expense in the year the related revenues are recognized. The Company's payments to the taxing authorities are based on the prior years' revenues. For 2008, 2007 and 2006, the Company included approximately $252 million, $185 million and $182 million, respectively, of revenue taxes in "operating revenues" and in "taxes, other than income taxes" expense.

**Repairs and maintenance costs**

Repairs and maintenance costs for overhauls of generating units are generally expensed as they are incurred.

**Allowance for Funds Used During Construction (AFUDC)**

AFUDC is an accounting practice whereby the costs of debt and equity funds used to finance plant construction are credited on the statement of income and charged to construction in progress on the balance sheet. If a project under construction is delayed for an extended period of time, as it was in the case of HELCO's installation of CT-4 and CT-5, AFUDC on the delayed project may be stopped.

The weighted-average AFUDC rate was 8.1% in 2008 and 2007 and 8.4% in 2006, and reflected quarterly compounding.

**Environmental expenditures**

The Company is subject to numerous federal and state environmental statutes and regulations. In general, environmental contamination treatment costs are charged to expense, unless it is probable that the PUC would allow such costs to be recovered in future rates, in which case such costs would be capitalized as regulatory assets. Also, environmental costs are capitalized if the costs extend the life, increase the capacity, or improve the safety or efficiency of property; the costs mitigate or prevent future environmental contamination; or the costs are incurred in preparing the property for sale. Environmental costs are either capitalized or charged to expense when environmental assessments and/or remedial efforts are probable and the cost can be reasonably estimated.

**Income taxes**

The Company is included in the consolidated income tax returns of HECO's parent, HEI. Income tax expense has been computed for financial statement purposes as if HECO and its subsidiaries filed separate consolidated HECO income tax returns.

Deferred income tax assets and liabilities are established for the temporary differences between the financial reporting bases and the tax bases of the Company's assets and liabilities at tax rates expected to be in effect when such deferred tax assets or liabilities are realized or settled. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

Federal and state investment tax credits are deferred and amortized over the estimated useful lives of the properties which qualified for the credits.

Governmental tax authorities could challenge a tax return position taken by management. If the Company's position does not prevail, the Company's results of operations and financial condition may be adversely affected as the related deferred or current income tax asset might be impaired and written down or written off or an unanticipated tax liability might be incurred.

Effective January 1, 2007, the Company adopted FIN No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109," and uses a "more-likely-than-not" recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

**Impairment of long-lived assets and long-lived assets to be disposed of**

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell.

**Recent accounting pronouncements and interpretations**

**Business combinations.** In December 2007, the FASB issued SFAS No. 141R, "Business Combinations." SFAS No. 141R requires an acquiring entity to recognize all the assets acquired and liabilities assumed at the acquisition-date fair value with limited exceptions. Under SFAS No. 141R, acquisition costs will generally be expensed as incurred, noncontrolling interests will be valued at acquisition-date fair value, and acquired contingent liabilities will be recorded at acquisition-date fair value and subsequently measured at the higher of such amount or the amount determined under existing guidance for non-acquired contingencies. The Company must adopt SFAS No. 141R for all business combinations for which the acquisition date is on or after January 1, 2009. Because the impact of adopting SFAS No. 141R will be dependent on future acquisitions, if any, management cannot currently predict such impact.

**Noncontrolling interests.** In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements." SFAS No. 160 requires the recognition of a noncontrolling interest (i.e., a minority interest) as equity in the consolidated financial statements, separate from the parent's equity, and requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the income statement. Under SFAS No. 160, changes in the parent's ownership interest that leave control intact are accounted for as capital transactions (i.e., as increases or decreases in ownership), a gain or loss will be recognized when a subsidiary is deconsolidated based on the fair value of the noncontrolling equity investment (not carrying amount), and entities must provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and of the noncontrolling owners. The Company adopted SFAS No. 160 prospectively on January 1, 2009, except for the presentation and disclosure requirements which must be applied retrospectively.

**The fair value option for financial assets and financial liabilities**. In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, which should improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company adopted SFAS No. 159 on January 1, 2008 and the adoption had no impact on the Company's financial statements as the Company did not choose to measure additional items at fair value.

**Fair value measurements**. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 applies to fair value measurements that are already required or permitted under existing accounting pronouncements with some exceptions. SFAS No. 157 retains the exchange price notion in defining fair value and clarifies that the exchange price is the price that would be received upon sale of an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability. It emphasizes that fair value is a market-based, not an entity-specific, measurement based upon the assumptions that consider credit and nonperformance risk market participants would use in pricing an asset or liability. As a basis for considering assumptions in fair value measurements, SFAS No. 157 establishes a hierarchy that gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). SFAS No. 157 expands disclosures about the use of fair value, including disclosure of the level within the hierarchy in which the fair value measurements fall and the effect of the measurements on earnings (or changes in net assets) for the period. The Company adopted SFAS No. 157 on January 1, 2008. The adoption of SFAS No. 157 for fair value measures of financial assets and financial liabilities had no impact on the Company's financial results, but have impacted the Company's fair value measurement disclosures.

FASB Staff Position (FSP) FAS 157-2 "Effective Date of FASB Statement No. 157," delays the effective date of SFAS No. 157 until fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis.

On January 1, 2009, the Company will be required to apply the provisions of SFAS No. 157 to fair value measurements of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company is in the process of evaluating the impact, if any, of applying these provisions on its financial position and results of operations.

In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active," which was effective immediately. FSP FAS 157-3 clarifies the application of SFAS No. 157 in cases where the market for a financial instrument is not active and provides an example to illustrate key considerations in determining fair value in those circumstances. The Company has considered the guidance provided by FSP FAS 157-3 in its determination of estimated fair values during 2008.

**Reclassifications**

Certain reclassifications have been made to prior years' financial statements to conform to the 2008 presentation.

## 2. Cumulative preferred stock

The following series of cumulative preferred stock are redeemable only at the option of the respective company at the following prices in the event of voluntary liquidation or redemption:

| December 31, 2008 | Voluntary Liquidation Price | Redemption Price |
|---|---|---|
| Series | | |
| C, D, E, H, J and K (HECO) | $ 20 | $ 21 |
| I (HECO) | 20 | 20 |
| G (HELCO) | 100 | 100 |
| H (MECO) | 100 | 100 |

HECO is obligated to make dividend, redemption and liquidation payments on the preferred stock of either of its subsidiaries if the respective subsidiary is unable to make such payments, but such obligation is subordinated to any obligation to make payments on HECO's own preferred stock.

### 3. Unconsolidated variable interest entities

***HECO Capital Trust III.*** HECO Capital Trust III (Trust III) was created and exists for the exclusive purposes of (i) issuing in March 2004 2,000,000 6.50% Cumulative Quarterly Income Preferred Securities, Series 2004 (2004 Trust Preferred Securities) ($50 million aggregate liquidation preference) to the public and trust common securities ($1.5 million aggregate liquidation preference) to HECO, (ii) investing the proceeds of these trust securities in 2004 Debentures issued by HECO in the principal amount of $31.5 million and issued by each of MECO and HELCO in the respective principal amounts of $10 million, (iii) making distributions on the trust securities and (iv) engaging in only those other activities necessary or incidental thereto. The 2004 Trust Preferred Securities are mandatorily redeemable at the maturity of the underlying debt on March 18, 2034, which maturity may be extended to no later than March 18, 2053; and are redeemable at the issuer's option without premium beginning on March 18, 2009. The 2004 Debentures, together with the obligations of HECO, HELCO and MECO under an expense agreement and HECO's obligations under its trust guarantee and its guarantee of the obligations of HELCO and MECO under their respective debentures, are the sole assets of Trust III. Trust III has at all times been an unconsolidated subsidiary of HECO. Since HECO, as the common security holder, does not absorb the majority of the variability of Trust III, HECO is not the primary beneficiary and does not consolidate Trust III in accordance with FIN 46R. Trust III's balance sheet as of December 31, 2008 consisted of $51.5 million of 2004 Debentures; $50.0 million of 2004 Trust Preferred Securities; and $1.5 million of trust common securities. Trust III's income statement for 2008 consisted of $3.4 million of interest income received from the 2004 Debentures; $3.3 million of distributions to holders of the Trust Preferred Securities; and $0.1 million of common dividends on the trust common securities to HECO. So long as the 2004 Trust Preferred Securities are outstanding, HECO is not entitled to receive any funds from Trust III other than pro rata distributions, subject to certain subordination provisions, on the trust common securities. In the event of a default by HECO in the performance of its obligations under the 2004 Debentures or under its Guarantees, or in the event HECO, HELCO or MECO elect to defer payment of interest on any of their respective 2004 Debentures, then HECO will be subject to a number of restrictions, including a prohibition on the payment of dividends on its common stock.

***Purchase power agreements.*** As of December 31, 2008, HECO and its subsidiaries had six PPAs for a total of 540 megawatts (MW) of firm capacity, and other PPAs with smaller IPPs and Schedule Q providers (i.e., customers with cogeneration and/or small power production facilities with a capacity of 100 kW or less who buy power from or sell power to the utilities) that supplied as-available energy. Approximately 91% of the 540 MW of firm capacity is under PPAs, entered into before December 31, 2003, with AES Hawaii, Inc. (AES Hawaii), Kalaeloa Partners, L.P. (Kalaeloa), Hamakua Energy Partners, L.P. (HEP) and HPOWER. Purchases from all IPPs for 2008 totaled $690 million, with purchases from AES Hawaii, Kalaeloa, HEP and HPOWER totaling $141 million, $273 million, $92 million and $60 million, respectively. The primary business activities of these IPPs are the generation and sale of power to HECO and its subsidiaries (and municipal waste disposal in the case of HPOWER). Current financial information about the size, including total assets and revenues, for many of these IPPs is not publicly available.

Under FIN 46R, an enterprise with an interest in a VIE or potential VIE created before December 31, 2003 (and not thereafter materially modified) is not required to apply FIN 46R to that entity if the enterprise is unable to obtain, after making an exhaustive effort, the necessary information.

HECO reviewed its significant PPAs and determined in 2004 that the IPPs at that time had no contractual obligation to provide such information. In March 2004, HECO and its subsidiaries sent letters to all of their IPPs, except the Schedule Q providers, requesting the information that they need to determine the applicability of FIN 46R to the respective IPP, and subsequently contacted most of the IPPs to explain and repeat its request for information. (HECO and its subsidiaries excluded their Schedule Q providers from the scope of FIN 46R because their variable interest in the provider would not be significant to the utilities and they did not participate significantly in the design of the provider.) Some of the IPPs provided sufficient information for HECO to determine that the IPP was not a VIE, or was either a "business" or "governmental organization" (e.g., HPOWER) as defined under FIN 46R, and thus excluded from the scope of FIN 46R. Other IPPs, including the three largest, declined to provide the information necessary for HECO to determine the applicability of FIN 46R, and HECO was unable to apply FIN 46R to these IPPs.

As required under FIN 46R since 2004, HECO has continued its efforts to obtain from the IPPs the information necessary to make the determinations required under FIN 46R. In each year beginning from 2005 through 2009, HECO and its subsidiaries sent letters to the IPPs that were not excluded from the scope of FIN 46R, requesting the information required to determine the applicability of FIN 46R to the respective IPP. All of these IPPs declined to provide necessary information, except that Kalaeloa provided the information pursuant to the amendments to its PPA (see below) and an entity owning a wind farm provided information as required under the PPA. Management has concluded that the consolidation of two entities owning wind farms was not required as MECO and HELCO do not have variable interests in the entities because the PPAs do not require them to absorb any variability of the entities.

If the requested information is ultimately received from the other IPPs, a possible outcome of future analysis is the consolidation of one or more of such IPPs in HECO's consolidated financial statements. The consolidation of any significant IPP could have a material effect on HECO's consolidated financial statements, including the recognition of a significant amount of assets and liabilities and, if such a consolidated IPP were operating at a loss and had insufficient equity, the potential recognition of such losses. If HECO and its subsidiaries determine they are required to consolidate the financial statements of such an IPP and the consolidation has a material effect, HECO and its subsidiaries would retrospectively apply FIN 46R in accordance with SFAS No. 154, "Accounting Changes and Error Corrections."

**Kalaeloa Partners, L.P.** In October 1988, HECO entered into a PPA with Kalaeloa, subsequently approved by the PUC, which provided that HECO would purchase 180 MW of firm capacity for a period of 25 years beginning in May 1991. In October 2004, HECO and Kalaeloa entered into amendments to the PPA, subsequently approved by the PUC, which together effectively increased the firm capacity from 180 MW to 208 MW. The energy payments that HECO makes to Kalaeloa include: 1) a fuel component, with a fuel price adjustment based on the cost of low sulfur fuel oil, 2) a fuel additives cost component, and 3) a non-fuel component, with an adjustment based on changes in the Gross National Product Implicit Price Deflator. The capacity payments that HECO makes to Kalaeloa are fixed in accordance with the PPA. Kalaeloa also has a steam delivery cogeneration contract with another customer, the term of which coincides with the PPA. The facility has been certified by the Federal Energy Regulatory Commission as a Qualifying Facility under the Public Utility Regulatory Policies Act of 1978.

Pursuant to the provisions of FIN 46R, HECO is deemed to have a variable interest in Kalaeloa by reason of the provisions of HECO's PPA with Kalaeloa. However, management has concluded that HECO is not the primary beneficiary of Kalaeloa because HECO does not absorb the majority of Kalaeloa's expected losses nor receive a majority of Kalaeloa's expected residual returns and, thus, HECO has not consolidated Kalaeloa in its consolidated financial statements. A significant factor affecting the level of expected losses HECO would absorb is the fact that HECO's exposure to fuel price variability is limited to the remaining term of the PPA as compared to the facility's remaining useful life. Although HECO absorbs fuel price variability for the remaining term of the PPA, the PPA does not currently expose HECO to losses as the fuel and fuel related energy payments under the PPA have been approved by the PUC for recovery from customers through base electric rates and through HECO's ECAC to the extent the fuel and fuel related energy payments are not included in base energy rates.

## 4. Long-term debt

For special purpose revenue bonds, funds on deposit with trustees represent the undrawn proceeds from the issuance of the special purpose revenue bonds and earn interest at market rates. These funds are available only to pay (or reimburse payment of) expenditures in connection with certain authorized construction projects and certain expenses related to the bonds.

On March 27, 2007, the Department of Budget and Finance of the State of Hawaii (the Department) issued (pursuant to a 2005 legislative authorization), at par, Series 2007A SPRBs in the aggregate principal amount of $140 million, with a maturity of March 1, 2037 and a fixed coupon interest rate of 4.65%, and loaned the proceeds to HECO ($100 million), HELCO ($20 million) and MECO ($20 million). Payment of the principal and interest on the SPRBs are insured by a surety bond issued by Financial Guaranty Insurance Company. Proceeds are being used to finance capital expenditures, including reimbursements to the electric utilities for previously incurred capital expenditures which, in turn, have been used primarily to repay short-term borrowings. As of December 31, 2008, approximately $3 million of proceeds from the Series 2007A SPRBs had not yet been drawn and were held by the construction fund trustee for HELCO. HELCO's long-term debt will increase from time to time as these remaining proceeds are drawn down. Proceeds from the Series 2007A SPRBs for HECO and MECO were fully drawn as of December 31, 2008.

On March 27, 2007, the Department also issued, at par, Refunding Series 2007B SPRBs in the aggregate principal amount of $125 million, with a maturity of May 1, 2026 and a fixed coupon interest rate of 4.60%, and loaned the proceeds to HECO ($62 million), HELCO ($8 million) and MECO ($55 million). Proceeds from the sale were applied, together with other funds provided by the electric utilities, to the redemption at par on May 1, 2007 of the $75 million aggregate principal amount of 6.20% Series 1996A SPRBs (which had an original maturity of May 1, 2026) and to the redemption at a 2% premium on April 27, 2007 of the $50 million aggregate principal amount of 5 7/8% Series 1996B SPRBs (which had an original maturity of December 1, 2026). Payment of the principal and interest on the refunding SPRBs are insured by a surety bond issued by Financial Guaranty Insurance Company.

At December 31, 2008, the aggregate payments of principal required on long-term debt are nil during the next three years, $57.5 million in 2012 and nil in 2013.

## 5. Short-term borrowings

There were no short-term borrowings from nonaffiliates at December 31, 2008. Short-term borrowings from nonaffiliates at December 31, 2007 had a weighted average interest rate of 5.4%, and consisted entirely of commercial paper.

At December 31, 2008 and 2007 the Company maintained syndicated credit facilities of $250 million and $175 million, respectively. The facilities are not secured. There were no borrowings under any line of credit during 2008 and 2007. See Note 13, "Related-party transactions," concerning borrowings from affiliates.

***Credit agreement.*** Effective April 3, 2006, HECO entered into a revolving unsecured credit agreement establishing a line of credit facility of $175 million with a syndicate of eight financial institutions. On March 14, 2007 the PUC issued a D&O approving HECO's request to maintain the credit facility for five years (until March 31, 2011), to borrow under the credit facility (including borrowings with maturities in excess of 364 days), to use the proceeds from any borrowings with maturities in excess of 364 days to finance capital expenditures and/or to repay short-term or other borrowings used to finance or refinance capital expenditures and to use an expedited approval process to obtain PUC approval to increase the facility amount, renew the facility, refinance the facility or change other terms of the facility if such changes are required or desirable.

Any draws on the facility bear interest, at the option of HECO, at either the "Adjusted LIBO Rate" plus 40 basis points or the greater of (a) the "Prime Rate" and (b) the sum of the "Federal Funds Rate" plus 50 basis points, as defined in the agreement. The annual fee is 8 basis points on the undrawn commitment amount. The agreement contains provisions for revised pricing in the event of a ratings change. For example, a ratings downgrade of HECO's Senior Debt Rating (e.g., from BBB+/Baa1 to BBB/Baa2 by S&P and Moody's, respectively) would result in a commitment fee increase of 2 basis points and an interest rate increase of 10 basis points on any drawn amounts. On the other hand, a ratings upgrade (e.g., from BBB+/Baa1 to A-/A3 by S&P or Moody's, respectively) would result in a commitment fee decrease of 1 basis point and an interest rate decrease of 10 basis points on any drawn amounts. The agreement does not contain clauses that would affect access to the lines by reason of a ratings downgrade, nor does it have a broad "material adverse change" clause. However, the agreement does contain customary conditions that must be met in order to draw on it, such as the accuracy of certain of its representations at the time of a draw and compliance with its covenants (such as covenants preventing its subsidiaries from entering into agreements that restrict the ability of the subsidiaries to pay dividends to, or to repay borrowings from, HECO, and restricting HECO's ability, as well as the ability of any of its subsidiaries, to guarantee indebtedness of the subsidiaries if such additional debt would cause the subsidiary's "Consolidated Subsidiary Funded Debt to Capitalization Ratio" to exceed 65% (ratios of 48% for HELCO and 44% for MECO as of December 31, 2008, as calculated under the agreement)). In addition to customary defaults, HECO's failure to maintain its financial ratios, as defined in its agreement, or meet other requirements will result in an event of default. For example, under the agreement, it is an event of default if HECO fails to maintain a "Consolidated Capitalization Ratio" (equity) of at least 35% (ratio of 55% as of December 31, 2008, as calculated under the agreement), if HECO fails to remain a wholly-owned subsidiary of HEI or if any event or condition occurs that results in any "Material Indebtedness" of HECO or any of its significant subsidiaries being subject to acceleration prior to its scheduled maturity. HECO's syndicated credit facility is maintained to support the issuance of commercial paper, but it may also be drawn for general corporate purposes and capital expenditures.

Effective December 8, 2008, HECO entered into a 9-month revolving unsecured credit agreement establishing a line of credit facility of $75 million, expiring on September 8, 2009, with Wells Fargo Bank National Association, as Administrative Agent and a lender, and U.S. Bank National Association, Bank of America, N.A. and Bank of Hawaii, as lenders. Similar to HECO's existing $175 million, 5-year revolving unsecured credit agreement, this agreement does not contain clauses that would affect access to the lines by reason of a ratings downgrade nor does it have a broad "material adverse change" clause. Major provisions of the credit agreement are substantially the same as provisions in HECO's existing $175 million credit agreement, except for pricing and prepayment requirements as noted below.

The annual fee is 25 basis points on the daily commitment amount. Any draws on the facility bear interest, at the option of HECO, at either the "Adjusted LIBO Rate" plus 175 basis points or the greatest of (a) the "Prime Rate", (b) the sum of the "Federal Funds Rate" plus 150 basis points, and (c) the "Adjusted LIBO Rate" for a one month Interest Period plus 150 basis points, as defined in the agreement. A ratings change would result in revised pricing. For example, a ratings downgrade of HECO's Issuer Ratings (e.g., from BBB+/Baa1 to BBB/Baa2 by S&P and Moody's, respectively) would result in a facility fee increase of 5 basis points, and an interest rate increase of 20 basis points on any drawn amounts. On the other hand, a ratings upgrade (e.g., from BBB+/Baa1 to A-/A3 by S&P or Moody's, respectively) would result in a facility fee decrease of 5 basis points, and an interest rate decrease of 20 basis points on any drawn amounts. This agreement includes a provision for mandatory prepayments and reductions in the commitment amount in the event of any Debt Issuance or Equity Capital Markets Transaction, as defined by the agreement, in the amount of 100% of the net cash proceeds received (provided, however, for purposes of the agreement, HECO's receipt of proceeds from special purpose revenue bond financings do not occur until such proceeds are disbursed to HECO by the construction fund trustee in accordance with the indenture pursuant to which the bonds are issued). This credit facility is maintained to provide back-up and liquidity for commercial paper borrowings and to provide funding for working capital needs, intercompany loans to subsidiaries and general corporate purposes.

On May 23, 2007, S&P lowered the long-term corporate credit and unsecured debt ratings on HECO, HELCO and MECO to BBB from BBB+ and stated that the downgrade "is the result of sustained weak bondholder protection parameters compounded by the financial pressure that continuous need for regulatory relief, driven by heightened capital expenditure requirements, is creating for the next few years." The pricing for future borrowings under the line of credit facility did not change since the pricing level is "determined by the higher of the two" ratings by S&P and Moody's, and Moody's ratings did not change.

**6. Regulatory assets and liabilities**

In accordance with SFAS No. 71, the Company's financial statements reflect assets, liabilities, revenues and expenses based on current cost-based rate-making regulations. Continued accounting under SFAS No. 71 generally requires that rates are established by an independent, third-party regulator; rates are designed to recover the costs of providing service; and it is reasonable to assume that rates can be charged to and collected from customers. Management believes its operations currently satisfy the SFAS No. 71 criteria. If events or circumstances should change so that those criteria are no longer satisfied, the Company expects that the regulatory assets would be charged to expense and the regulatory liabilities would be credited to income or refunded to ratepayers. In the event of unforeseen regulatory actions or other circumstances, management believes that a material adverse effect on the Company's results of operations and financial position may result if regulatory assets have to be charged to expense without an offsetting credit for regulatory liabilities or if regulatory liabilities are required to be refunded to ratepayers.

Regulatory assets represent deferred costs expected to be fully recovered through rates over PUC-authorized periods. Generally, the Company does not earn a return on its regulatory assets; however, it has been allowed to recover interest on its regulatory assets for demand-side management program costs. Regulatory liabilities represent amounts included in rates and collected from ratepayers for costs expected to be incurred in the future. For example, the regulatory liability for cost of removal in excess of salvage value represents amounts that have been collected from ratepayers for costs that are expected to be incurred in the future to retire utility plant. Noted in parentheses are the original PUC authorized amortization or recovery periods and the remaining amortization or recovery periods as of December 31, 2008, if different.

Regulatory assets were as follows:

| December 31 | 2008 | 2007 |
|---|---|---|
| (in thousands) | | |
| Retirement benefit plans (5 years; 3 years for HELCO's $8 million prepaid pension regulatory asset, indeterminate for remainder) | $416,680 | $169,814 |
| Income taxes, net (1 to 36 years) | 77,660 | 74,605 |
| Postretirement benefits other than pensions (18 years; 4 years) | 7,159 | 8,949 |
| Unamortized expense and premiums on retired debt and equity issuances (14 to 30 years; 1 to 20 years) | 16,191 | 17,510 |
| Demand-side management program costs, net (1 year) | 2,571 | 4,113 |
| Vacation earned, but not yet taken (1 year) | 6,654 | 5,997 |
| Other (1 to 20 years) | 3,704 | 4,002 |
| | $530,619 | $284,990 |

Regulatory liabilities were as follows:

| December 31 | 2008 | 2007 |
|---|---|---|
| (in thousands) | | |
| Cost of removal in excess of salvage value (1 to 60 years) | $282,400 | $259,765 |
| Retirement benefit plans (5 years beginning with respective utility's next rate case) | 4,718 | -- |
| Other (5 years; 1 to 5 years) | 1,484 | 1,841 |
| | $288,602 | $261,606 |

The regulatory asset and liability relating to retirement benefit plans was created as a result of pension and OPEB tracking mechanisms adopted by the PUC in interim rate case decisions for HECO, MECO and HELCO in 2007 (see Note 10).

## 7. Income taxes

In June 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109," which prescribes a "more-likely-than-not" recognition threshold and measurement attribute (the largest amount of benefit that is greater than 50% likely of being realized upon ultimate resolution with tax authorities) for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. The Company adopted FIN 48 in the first quarter of 2007.

As a result of the implementation of FIN 48, the Company reclassified certain deferred tax liabilities to a liability for uncertain tax positions (FIN 48 liability) and reduced retained earnings by $0.6 million as of January 1, 2007 for the cumulative effect of the adoption of FIN 48.

The Company records interest on income taxes in "Interest and other charges." For 2008, 2007 and 2006, interest (income) expense on income taxes was $0.5 million, $0.6 million and ($0.3) million, respectively.

The Company will record penalties, if any, in "Other, net" under "Other income". As of December 31, 2008 and 2007, the total amount of accrued interest related to uncertain tax positions and recognized on the balance sheet was $1.7 million and $1.2 million, respectively.

As of December 31, 2008, the total amount of FIN 48 liability was $5.5 million and, of this amount, $0.3 million, if recognized, would affect the Company's effective tax rate. Management concluded that it is reasonably possible that the FIN 48 liability will significantly change within the next 12 months due to the resolution of issues under examination by the Internal Revenue Service and estimates the range of the reasonably possible change to be a decrease of between nil to $4.3 million in 2009.

The changes in total unrecognized tax benefits were as follows:

| Years ended December 31 | 2008 | 2007 |
|---|---|---|
| (in millions) | | |
| Unrecognized tax benefits, January 1 | $ 24.4 | $ 23.6 |
| Additions based on tax positions taken during the year | - | - |
| Reductions based on tax positions taken during the year | - | - |
| Additions for tax positions of prior years | 0.1 | 0.8 |
| Reductions for tax positions of prior years | (0.3) | - |
| Decreases due to tax positions taken | - | - |
| Settlements | - | - |
| Lapses of statute of limitations | - | - |
| Unrecognized tax benefits, December 31 | $ 24.2 | $ 24.4 |

In addition to the FIN 48 liability, the Company's unrecognized tax benefits include $18.7 million of tax benefits related to refund claims, which did not meet the recognition threshold. Consequently, tax benefits have not been recorded on these claims and no FIN 48 liability was required to offset these potential benefits.

Tax years 2003 to 2007 currently remain subject to examination by the Internal Revenue Service and Department of Taxation of the State of Hawaii.

The Company's effective federal and state income tax rate for 2008 was 38%, compared to an effective tax rate for 2007 of 37%.

The components of income taxes charged to operating expenses were as follows:

| December 31<br>(in thousands) | 2008 | 2007 | 2006 |
|---|---|---|---|
| Federal: | | | |
| Current | $44,759 | $54,767 | $50,208 |
| Deferred | 6,040 | (22,853) | (7,000) |
| Deferred tax credits, net | (1,094) | (1,154) | (1,259) |
| | 49,705 | 30,760 | 41,949 |
| State: | | | |
| Current | 6,522 | 5,073 | 2,889 |
| Deferred | (1,391) | (3,699) | (1,267) |
| Deferred tax credits, net | 1,471 | 1,992 | 3,810 |
| | 6,602 | 3,366 | 5,432 |
| Total | $56,307 | $34,126 | $47,381 |

Income tax benefits related to nonoperating activities, included in "Other, net" on the consolidated statements of income, amounted to $0.5 million, $3.2 million and $0.9 million for 2008, 2007 and 2006, respectively.

A reconciliation between income taxes charged to operating expenses and the amount of income taxes computed at the federal statutory rate of 35% on income before income taxes and preferred stock dividends follows:

| December 31<br>(in thousands) | 2008 | 2007 | 2006 |
|---|---|---|---|
| Amount at the federal statutory income tax rate | $52,907 | $32,559 | $44,024 |
| State income taxes on operating income, net of effect on federal income taxes | 4,291 | 2,188 | 3,530 |
| Other | (891) | (621) | (173) |
| Income taxes charged to operating expenses | $56,307 | $34,126 | $47,381 |

The tax effects of book and tax basis differences that give rise to deferred tax assets and liabilities were as follows:

| December 31<br>(in thousands) | 2008 | 2007 |
|---|---|---|
| Deferred tax assets: | | |
| Cost of removal in excess of salvage value | $109,882 | $101,075 |
| Contributions in aid of construction and customer advances | 78,834 | 76,342 |
| Other | 16,529 | 21,753 |
| | 205,245 | 199,170 |
| Deferred tax liabilities: | | |
| Property, plant and equipment | 313,250 | 287,231 |
| Regulatory assets, excluding amounts attributable to property, plant and equipment | 30,240 | 29,050 |
| Retirement benefits | 4,728 | 15,590 |
| Change in accounting method | 16,020 | 23,036 |
| Retirement benefits in Accumulated Other Comprehensive Income (AOCI) | 1,052 | 736 |
| Other | 6,265 | 5,640 |
| | 371,555 | 361,283 |
| Net deferred income tax liability | $166,310 | $162,113 |

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Based upon historical taxable income and projections for future taxable income and available tax planning strategies, management believes it is more likely than not the Company will realize substantially all of the benefits of the deferred tax assets.

As of December 31, 2008, the FIN 48 disclosures above present the Company's accrual for potential tax liabilities and related interest. Based on information currently available, the Company believes this accrual has adequately provided for potential income tax issues with federal and state tax authorities and related interest, and that the ultimate resolution of tax issues for all open tax periods will not have a material adverse effect on its results of operations, financial condition or liquidity.

## 8. Cash flows

**Supplemental disclosures of cash flow information**

Cash paid for interest (net of AFUDC-Debt) and income taxes was as follows:

| Years ended December 31 (in thousands) | 2008 | 2007 | 2006 |
|---|---|---|---|
| Interest | $48,357 | $47,155 | $47,206 |
| Income taxes | $91,043 | $26,106 | $52,782 |

**Supplemental disclosures of noncash activities**

The allowance for equity funds used during construction, which was charged primarily to construction in progress, amounted to $9.4 million, $5.2 million and $6.3 million in 2008, 2007 and 2006, respectively.

The estimated fair value of noncash contributions in aid of construction amounted to $9.8 million, $17.7 million and $13.5 million in 2008, 2007 and 2006, respectively.

## 9. Major customers

HECO and its subsidiaries received approximately 10% ($295 million), 9% ($194 million) and 10% ($197 million), of their operating revenues from the sale of electricity to various federal government agencies in 2008, 2007 and 2006, respectively.

## 10. Retirement benefits

***Pensions***

Substantially all of the employees of HECO, HELCO and MECO participate in the Retirement Plan for Employees of Hawaiian Electric Industries, Inc. and Participating Subsidiaries (the Plan). The Plan is a qualified, non-contributory defined benefit pension plan and includes benefits for union employees determined in accordance with the terms of the collective bargaining agreements between the utilities and their respective unions. The Plan is subject to the provisions of the ERISA. In addition, some current and former executives and directors participate in noncontributory, nonqualified plans (collectively, Supplemental Plans). In general, benefits are based on the employees' or directors' years of service and compensation.

The continuation of the Plan and the Supplemental Plans and the payment of any contribution thereunder are not assumed as contractual obligations by the participating employers. The Directors' Plan has been frozen since 1996. The HEI Supplemental Executive Retirement Plan (noncontributory, nonqualified, defined benefit plan) was frozen as of December 31, 2008. No participants have accrued any benefits under these plans after the plan's freeze and the plans will be terminated at the time all remaining benefits have been paid.

Each participating employer reserves the right to terminate its participation in the applicable plans at any time. If a participating employer terminates its participation in the Plan, the interest of each affected participant would become 100% vested to the extent funded. Upon the termination of the Plan, assets would be distributed to affected participants in accordance with the applicable allocation provisions of ERISA and any excess assets that exist would be paid to the participating employers. Participants' benefits in the Plan are covered up to certain limits under insurance provided by the Pension Benefit Guaranty Corporation.

To determine pension costs for HECO, HELCO and MECO under the Plan and the Supplemental Plans, it is necessary to make complex calculations and estimates based on numerous assumptions, including the assumptions identified below.

***Postretirement benefits other than pensions***

The Company provides eligible employees health and life insurance benefits upon retirement under the Postretirement Welfare Benefits Plan for Employees of Hawaiian Electric Company, Inc. and participating employers (HECO Benefits Plan). Health benefits are also provided to dependents of eligible retired employees. The contribution for health benefits paid by the participating employers is based on the retirees' years of service and retirement dates. Generally, employees are eligible for these benefits if, upon retirement from active employment, they are eligible to receive benefits from the Plan.

Among other provisions, the HECO Benefits Plan provides prescription drug benefits for Medicare-eligible participants who retire after 1998. Retirees who are eligible for the drug benefits are required to pay a portion of the cost each month. The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the 2003 Act) expanded Medicare to include for the first time coverage for prescription drugs. The 2003 Act provides that persons eligible for Medicare benefits can enroll in Part D, prescription drug coverage, for a monthly premium. Alternatively, if an employer sponsors a retiree health plan that provides benefits determined to be actuarially equivalent to those covered under the Medicare standard prescription drug benefit, the employer will be paid a subsidy of 28 percent of a participant's drug costs between $250 and $5,000 (indexed for inflation) if the participant waives coverage under Medicare Part D.

The continuation of the HECO Benefits Plan and the payment of any contribution thereunder is not assumed as a contractual obligation by the participating employers. Each participating employer reserves the right to terminate its participation in the plan at any time.

***SFAS No. 158***

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)," which requires employers to recognize on their balance sheets the funded status of defined benefit pension and other postretirement benefit plans with an offset to Accumulated Other Comprehensive Income (AOCI) in stockholders' equity (using the projected benefit obligation (PBO) rather than the accumulated benefit obligation (ABO), to calculate the funded status of pension plans).

By application filed on December 8, 2005 (AOCI Docket), the Company requested the PUC to permit it to record, as a regulatory asset pursuant to SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," the amount that would otherwise be charged against stockholders' equity as a result of recording a minimum pension liability as prescribed by SFAS No. 87. The Company updated its application in the AOCI Docket in November 2006 to take into account SFAS No. 158. On January 26, 2007, the PUC issued a D&O in the updated AOCI Docket, which denied the Company's request to record a regulatory asset on the grounds that the Company had not met its burden of proof to show that recording a regulatory asset was warranted, or that there would be adverse consequences if a regulatory asset was not recorded. The PUC also required HECO to submit a pension study (determining whether ratepayers are better off with a well-funded pension plan, a minimally-funded pension plan, or something in between) in its pending 2007 test year rate case, as proposed by the Company in support of its request.

In HELCO's 2006, HECO's 2007 and MECO's 2007 test year rate cases, the Company and the Consumer Advocate proposed adoption of pension and OPEB tracking mechanisms, which are intended to smooth the impact to ratepayers of potential fluctuations in pension and OPEB costs. Under the tracking mechanisms, any costs determined under SFAS Nos. 87 and 106, as amended, that are over/under amounts allowed in rates are charged/credited to a regulatory asset/liability. The regulatory asset/liability for each utility will be amortized over 5 years beginning with the respective utility's next rate case.

The pension tracking mechanisms generally require the Company to fund only the minimum level required under the law until the existing pension assets are reduced to zero, at which time the Company would make contributions to the pension trust in the amount of the actuarially calculated net periodic pension costs, except when limited by the ERISA minimum contribution requirements or the maximum contribution limitation on deductible contributions imposed by the Internal Revenue Code. The OPEB tracking mechanisms generally require the Company to make contributions to the OPEB trust in the amount of the actuarially calculated net periodic benefit costs, except when limited by material, adverse consequences imposed by federal regulations.

A pension funding study was filed in the HECO rate case in May 2007. The conclusions in the study were consistent with the funding practice proposed with the pension tracking mechanism.

In its 2007 interim decisions for HELCO's 2006, HECO's 2007 and MECO's 2007 test year rate cases, the PUC approved the adoption of the proposed pension and OPEB tracking mechanisms on an interim basis (subject to the PUC's final D&Os) and established the amount of net periodic benefit costs to be recovered in rates by each utility. Under HELCO's interim order, a regulatory asset (representing HELCO's $12.8 million prepaid pension asset as of December 31, 2006 prior to the adoption of SFAS No. 158) was allowed to be recovered (and is being amortized) over a period of five years and was allowed to be included in HELCO's rate base, net of deferred income taxes. On October 25, 2007, however, the PUC issued an amended proposed final D&O for HECO's 2005 test year rate case, which reversed the portion of the interim D&O related to the inclusion of HECO's approximately $50 million pension asset, net of deferred income taxes, in rate base, and required a refund of revenues associated with that reversal, including interest, retroactive to September 28, 2005 (the date the interim increase became effective). In 2007, HECO accrued $16 million for the potential customer refunds, including interest, reducing 2007 net income by $9 million. The final D&O for HECO's 2005 test year rate case confirmed the refund. In the settlement agreement and interim PUC decision in HECO's 2007 test year rate case, HECO's pension asset was not included in HECO's rate base and amortization of the pension asset was not included as part of the pension tracking mechanism adopted in the proceeding on an interim basis. In HECO's rate increase application based on a 2009 test year, HECO's pension asset was not included in rate base and the amortization of the pension asset was not included in the revenue requirements. In the settlement agreement and interim PUC decision in MECO's 2007 test year rate case, MECO's pension asset ($1 million as of December 31, 2007) was not included in MECO's rate base and amortization of the pension asset was not included as part of the pension tracking mechanism adopted in the proceeding on an interim basis.

As a result of the 2007 interim orders, the Company has reclassified to a regulatory asset charges for retirement benefits that would otherwise be recorded in AOCI pursuant to SFAS No. 158 (amounting to the elimination of a potential charge to AOCI of $249 million pre-tax and $171 million pre-tax at December 31, 2008 and at December 31, 2007, respectively, compared to a retirement benefits pre-tax charge of $207 million at December 31, 2006).

Retirement benefits expense for the Company for 2008, 2007 and 2006 was $27 million, $27 million and $22 million, respectively.

***Pension and other postretirement benefit plans information***

The changes in the obligations and assets of the Company's retirement benefit plans and the changes in AOCI (gross) for 2008 and 2007 and the funded status of these plans and amounts related to these plans reflected in the Company's balance sheet as of December 31, 2008 and 2007 were as follows:

| | 2008 | | 2007 | |
|---|---|---|---|---|
| (in thousands) | Pension benefits | Other benefits | Pension benefits | Other benefits |
| Benefit obligation, January 1 | $ 903,012 | $181,926 | $ 877,365 | $186,359 |
| *Service cost* | 26,902 | 4,643 | 25,527 | 4,652 |
| Interest cost | 53,973 | 10,699 | 51,588 | 10,512 |
| Actuarial (gain) loss | (65,390) | (12,541) | (7,084) | (10,671) |
| Benefits paid and expenses | (45,655) | (9,167) | (44,384) | (8,926) |
| Benefit obligation, December 31 | 872,842 | 175,560 | 903,012 | 181,926 |
| Fair value of plan assets, January 1 | 809,901 | 145,524 | 784,163 | 133,815 |
| Actual return (loss) on plan assets | (218,941) | (40,378) | 67,378 | 11,390 |
| Employer contribution | 5,294 | 8,402 | 2,846 | 9,293 |
| Benefits paid and expenses | (45,522) | (9,152) | (44,486) | (8,974) |
| Fair value of plan assets, December 31 | 550,732 | 104,396 | 809,901 | 145,524 |
| Accrued benefit liability, December 31 | (322,110) | (71,164) | (93,111) | (36,402) |
| AOCI, January 1 (excluding impact of PUC D&Os) | 153,206 | 15,909 | 176,057 | 31,258 |
| Recognized during year – net recognized transition obligation | - | (3,130) | (1) | (3,130) |
| Recognized during year – prior service (cost)/credit | 762 | - | 762 | - |
| Recognized during year – net actuarial losses | (6,577) | - | (10,486) | - |
| Occurring during year – net actuarial losses (gains) | 218,742 | 38,625 | (13,126) | (12,219) |
| | 366,133 | 51,404 | 153,206 | 15,909 |
| Cumulative impact of PUC D&Os | (365,874) | (54,365) | (152,888) | (18,120) |
| AOCI, December 31 | 259 | (2,961) | 318 | (2,211) |
| Net actuarial loss | 369,489 | 38,886 | 157,324 | 260 |
| Prior service gain | (3,356) | - | (4,118) | - |
| Net transition obligation | - | 12,518 | - | 15,649 |
| | 366,133 | 51,404 | 153,206 | 15,909 |
| Cumulative impact of PUC D&Os | (365,874) | (54,365) | (152,888) | (18,120) |
| AOCI, December 31 | 259 | (2,961) | 318 | (2,211) |
| Income tax benefits | (101) | 1,152 | (124) | 860 |
| AOCI, net of taxes, December 31 | $ 158 | $ (1,809) | $ 194 | $ (1,351) |

The Company does not expect any plan assets to be returned to the Company during calendar year 2009.

The dates used to determine retirement benefit measurements for the defined benefit plans were December 31 of 2008, 2007 and 2006.

The defined benefit pension plans' ABO, which do not consider projected pay increases (unlike the PBO shown in the table above), as of December 31, 2008 and 2007 were $783 million and $794 million, respectively.

The Company's current estimate of contributions to the retirement benefit plans in 2009 is $31 million. The Pension Protection Act provides that more conservative assumptions be used to value obligations if a pension plan's funded status falls below certain levels. Depending on the funded status of the plans and whether funding relief is provided through legislation, the Company's projected contribution level for the qualified pension plans for the 2010 plan year could fall in a range between $76 million and $136 million. Other factors could cause required contribution levels to fall outside this estimated range. Further, if the funded status of the pension plans continue to decline, restrictions on participant benefit accruals may be placed on the plans.

As of December 31, 2008, the benefits expected to be paid under the retirement benefit plans in 2009, 2010, 2011, 2012, 2013 and 2014 through 2018 amounted to $59 million, $61 million, $63 million, $65 million, $68 million and $385 million, respectively.

The Company has determined the market-related value of retirement benefit plan assets by calculating the difference between the expected return and the actual return on the fair value of the plan assets, then amortizing the difference over future years – 0% in the first year and 25% in years two to five, and finally adding or subtracting the unamortized differences for the past four years from fair value. The method includes a 15% range around the fair value of such assets (i.e., 85% to 115% of fair value). If the market-related value is outside the 15% range, then the amount outside the range will be recognized immediately in the calculation of annual net periodic benefit cost.

A primary goal of the plans is to achieve long-term asset growth sufficient to pay future benefit obligations at a reasonable level of risk. The investment policy target for defined benefit pension and OPEB plans reflects the philosophy that long-term growth can best be achieved by prudent investments in equity securities while balancing overall fund volatility by an appropriate allocation to fixed income securities. In order to reduce the level of portfolio risk and volatility in returns, efforts have been made to diversify the plans' investments by asset class, geographic region, market capitalization and investment style.

The weighted-average asset allocation of retirement defined benefit plans was as follows:

| | Pension benefits | | | | Other benefits | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Investment policy | | | | Investment policy | |
| December 31 | 2008 | 2007 | Target | Range | 2008 | 2007 | Target | Range |
| Asset category | | | | | | | | |
| Equity securities | 62% | 72% | 70% | 65-75% | 63% | 70% | 70% | 65-75% |
| Fixed income | 37 | 27 | 30 | 25-35% | 37 | 30 | 30 | 25-35% |
| Other [1] | 1 | 1 | – | – | – | – | – | – |
| | 100% | 100% | 100% | | 100% | 100% | 100% | |

[1] Other includes alternative investments, which are relatively illiquid in nature and will remain as plan assets until an appropriate liquidation opportunity occurs.

The following weighted-average assumptions were used in the accounting for the plans:

| | Pension benefits | | | Other benefits | | |
|---|---|---|---|---|---|---|
| December 31 | 2008 | 2007 | 2006 | 2008 | 2007 | 2006 |
| Benefit obligation | | | | | | |
| Discount rate | 6.625% | 6.125% | 6.00% | 6.50% | 6.125% | 6.00% |
| Rate of compensation increase | 3.5 | 4.0 | 4.0 | 3.5 | 4.0 | 4.0 |
| Net periodic benefit cost (years ended) | | | | | | |
| Discount rate | 6.125 | 6.00 | 5.75 | 6.125 | 6.00 | 5.75 |
| Expected return on plan assets | 8.5 | 8.5 | 9.0 | 8.5 | 8.5 | 9.0 |
| Rate of compensation increase | 4.2 | 4.0 | 4.6 | 4.2 | 4.0 | 4.6 |

The Company based its selection of an assumed discount rate for 2009 net periodic cost and December 31, 2008 disclosure on a cash flow matching analysis that utilized bond information provided by Standard & Poor's for all non-callable, high quality bonds (i.e., rated AA- or better) as of December 31, 2008. In selecting the expected rate of return on plan assets of 8.25% for 2009 net periodic benefit cost, the Company considered economic forecasts for the types of investments held by the plans (primarily equity and fixed income investments), the plans' asset allocations and the past performance of the plans' assets. The methods of selecting the assumed discount rate and expected return on plan assets at December 31, 2008 did not change from December 31, 2007.

As of December 31, 2008, the assumed health care trend rates for 2009 and future years were as follows: medical, 10.00%, grading down to 5.00% for 2014 and thereafter; dental, 5.00%; and vision, 4.00%. As of December 31, 2007, the assumed health care trend rates for 2008 and future years were as follows: medical, 10.00%, grading down to 5.00% for 2013 and thereafter; dental, 5.00%; and vision, 4.00%.

The components of net periodic benefit cost were as follows:

| (in thousands) | Pension benefits 2008 | 2007 | 2006 | Other benefits 2008 | 2007 | 2006 |
|---|---|---|---|---|---|---|
| Service cost | $26,902 | $25,527 | $26,719 | $4,643 | $4,652 | $4,965 |
| Interest cost | 53,973 | 51,588 | 48,348 | 10,699 | 10,512 | 10,337 |
| Expected return on plan assets | (65,191) | (61,101) | (64,467) | (10,789) | (9,778) | (9,758) |
| Amortization of net transition obligation | – | 1 | 2 | 3,130 | 3,130 | 3,130 |
| Amortization of net prior service gain | (762) | (762) | (770) | – | – | – |
| Amortization of net actuarial loss | 6,577 | 10,486 | 10,699 | – | – | 388 |
| Net periodic benefit cost | 21,499 | 25,739 | 20,531 | 7,683 | 8,516 | 9,062 |
| Impact of PUC D&Os | 5,859 | 1,195 | – | 1,038 | 187 | – |
| Net periodic benefit cost (adjusted for impact of PUC D&Os) | $27,358 | $26,934 | $20,531 | $8,721 | $8,703 | $9,062 |

The estimated prior service credit, net actuarial loss and net transition obligation for defined benefits pension plans that will be amortized from AOCI or regulatory asset into net periodic pension benefit cost over 2009 are $0.7 million, $14.7 million and nil, respectively. The estimated prior service cost, net actuarial loss and net transitional obligation for other benefit plans that will be amortized from AOCI or regulatory asset into net periodic other than pension benefit cost over 2009 are nil, $0.5 million and $3.1 million, respectively.

The Company recorded pension expense of $20 million, $20 million and $15 million and OPEB expense of $7 million each year in 2008, 2007 and 2006, respectively, and charged the remaining amounts primarily to electric utility plant.

All pension plans had ABOs exceeding plan assets as of December 31, 2008. The PBO, ABO and fair value of plan assets for pension plans with an ABO in excess of plan assets were $4 million, $3 million and nil, respectively, as of December 31, 2007. All other benefits plans had APBOs exceeding plan assets as of December 31, 2008 and December 31, 2007.

The health care cost trend rate assumptions can have a significant effect on the amounts reported for other benefits. As of December 31, 2008, a one-percentage-point increase in the assumed health care cost trend rates would have increased the total service and interest cost by $0.1 million and the PBO by $2.5 million, and a one-percentage-point decrease would have reduced the total service and interest cost by $0.2 million and the PBO by $3.0 million.

## 11. Commitments and contingencies

**Fuel contracts.** HECO and its subsidiaries have contractual agreements to purchase minimum quantities of fuel oil and diesel fuel through December 31, 2014 (at prices tied to the market prices of petroleum products in Singapore and Los Angeles). Based on the average price per barrel as of January 1, 2009, the estimated cost of minimum purchases under the fuel supply contracts is $0.4 billion per year for 2009 through 2012 and a total of $0.9 billion for the period 2013 through 2014. The actual cost of purchases in 2009 and future years could vary substantially from this estimate as a result of changes in market prices, quantities actually purchased and/or other factors. HECO and its subsidiaries purchased $1.2 billion, $795 million and $755 million of fuel under contractual agreements in 2008, 2007 and 2006, respectively.

**Power purchase agreements.** As of December 31, 2008, HECO and its subsidiaries had six firm capacity PPAs for a total of 540 megawatts (MW) of firm capacity. Purchases from these six independent power producers (IPPs) and all other IPPs totaled $690 million, $537 million and $507 million for 2008, 2007 and 2006, respectively. The PUC allows rate recovery for energy and firm capacity payments to IPPs under these agreements. Assuming that each of the agreements remains in place for its current term and the minimum availability criteria in the PPAs are met, aggregate minimum fixed capacity charges are expected to be approximately $0.1 billion per year for 2009 through 2013 and a total of $0.9 billion in the period from 2014 through 2030.

In general, HECO and its subsidiaries base their payments under the PPAs upon available capacity and energy and they are generally not required to make payments for capacity if the contracted capacity is not available, and payments are reduced, under certain conditions, if available capacity drops below contracted levels. In general, the payment rates for capacity have been predetermined for the terms of the agreements. Energy payments will vary over the terms of the agreements. HECO and its subsidiaries pass on changes in the fuel component of the energy charges to customers through the ECAC in their rate schedules (see "Energy cost adjustment clauses" below). HECO and its subsidiaries do not operate, or participate in the operation of, any of the facilities that provide power under the agreements. Title to the facilities does not pass to HECO or its subsidiaries upon expiration of the agreements, and the agreements do not contain bargain purchase options for the facilities.

**Hawaii Clean Energy Initiative.** In January 2008, the State of Hawaii and U.S. Department of Energy (DOE) signed a memorandum of understanding establishing the Hawaii Clean Energy Initiative (HCEI). The stated purpose of the HCEI is to establish a long-term partnership between the State of Hawaii and the DOE that will result in a fundamental and sustained transformation in the way in which energy resources are planned and used in the State. HECO has been working with the State and the DOE and other stakeholders to align the utility's energy plans with the State's plans.

On October 20, 2008, the Governor of the State of Hawaii, the State of Hawaii Department of Business, Economic Development and Tourism, the Division of Consumer Advocacy of the State of Hawaii Department of Commerce and Consumer Affairs, and HECO, on behalf of itself and its subsidiaries, HELCO and MECO (collectively, the parties), signed an Energy Agreement setting forth goals and objectives under the HCEI and the related commitments of the parties (the Energy Agreement). The Energy Agreement provides that the parties pursue a wide range of actions with the purpose of decreasing the State of Hawaii's dependence on imported fossil fuels through substantial increases in the use of renewable energy and implementation of new programs intended to secure greater energy efficiency and conservation.

The parties recognize that the move toward a more renewable and distributed and intermittent power system will pose increased operating challenges to the utilities and that there is a need to assure that Hawaii preserves a stable electric grid to minimize disruption in service quality and reliability. They further recognize that Hawaii needs a system of utility regulation to transform the utilities from traditional sales-based companies to energy services companies while preserving financially sound utilities.

Many of the actions and programs included in the Energy Agreement will require approval of the PUC in proceedings that will need to be initiated by the PUC or the utilities.

Among the major provisions of the Energy Agreement most directly affecting HECO and its subsidiaries are the following:

The Energy Agreement provides for the parties to pursue an overall goal of providing 70% of Hawaii's electricity and ground transportation energy needs from clean energy sources, including renewable energy and energy efficiency, by 2030. The ground transportation energy needs included in this goal include a contemplated move in Hawaii to electrification of transportation and the use of electric utility capacity in off peak hours to recharge vehicles and batteries. To promote the transportation goals, the Energy Agreement provides for the parties to evaluate and implement incentives to encourage adoption of electric vehicles, and to lead by example by acquiring hybrid or electric-only vehicles for government and utility fleets.

To help achieve the HCEI goals, the Energy Agreement further provides for the parties to seek amendment to the Hawaii Renewable Portfolio Standards (RPS) law (law which establishes renewable energy requirements for electric utilities that sell electricity for consumption in the State) to increase the current requirements from 20% to 25% by the year 2020, and to add a further RPS goal of 40% by the year 2030. The revised RPS law would also require that after 2014 the RPS goal be met solely with renewable energy generation versus including energy savings from energy efficiency measures. However, energy savings from energy efficiency measures would be counted toward the achievement of the overall HCEI 70% goal.

In December 2007, the PUC issued a D&O approving a stipulated RPS framework to govern electric utilities' compliance with the RPS law. In a follow up order in December 2008, the PUC approved a penalty of $20 for every MWh that an electric utility is deficient under Hawaii's RPS law. The PUC noted, however, that this penalty may be reduced, in the PUC's discretion, due to events or circumstances that are outside an electric utility's reasonable control, to the extent the event or circumstance could not be reasonably foreseen and ameliorated, as described in the RPS law and in the RPS Framework. In addition, the PUC ordered that: (1) any penalties assessed against HECO and its subsidiaries for failure to meet the RPS will go into the public benefits fund account used to support energy efficiency and DSM programs and services, unless otherwise directed; and (2) the utilities will be prohibited from recovering any RPS penalty costs through rates.

To further encourage the contributions of energy efficiency to the overall HCEI goal, the Energy Agreement provides for the parties to seek establishment of energy efficiency goals through an Energy Efficiency Portfolio Standard.

To help fund energy efficiency programs, incentives, program administration, customer education, and other related program costs, as expended by the third-party administrator for the energy efficiency programs or by program contractors, which may include the utilities, the Energy Agreement provides that the parties will request that the PUC establish a Public Benefits Fund (PBF) that is funded by collecting 1% of the utilities' revenues in years one and two after implementation of a PBF; 1.5% in years three and four; and 2% thereafter. Such PBF funds are expected to be collected from customers in lieu of the amounts currently collected for specific existing DSM programs. In December 2008, the PUC issued an order directing the utilities to collect revenue equal to 1% of the projected total electric revenue of the utilities, of which 60% shall be collected via the DSM surcharge and 40% via the PBF surcharge. Beginning January 1, 2009, the 1% is being assessed statewide. Such PBF funds are currently being collected from customers in lieu of the amounts currently collected for specific existing DSM programs.

The Energy Agreement provides for the establishment of a Clean Energy Infrastructure Surcharge (CEIS). The CEIS, which will need to be approved by the PUC, is to be designed to expedite cost recovery for a variety of infrastructure that supports greater use of renewable energy or grid efficiency within the utility systems (such as advanced metering, energy storage, interconnections and interfaces). The Energy Agreement provides that the surcharge should be available to recover costs that would normally be expensed in the year incurred and capital costs (including the allowed return on investment, AFUDC, depreciation, applicable taxes and other approved costs), and could also be used to recover costs stranded by clean energy initiatives. On November 28, 2008, HECO and the Consumer Advocate filed a joint letter informing the PUC that the pending REIP Surcharge satisfies the Energy Agreement provision for an implementation procedure for the CEIS recovery mechanism and that no further regulatory action on the CEIS is necessary, and reaffirming that the REIP Surcharge is ready for PUC decision-making. In February 2009, the PUC issued to the parties information requests prepared by its consultant.

HECO and its subsidiaries will continue to negotiate with developers of currently proposed projects (identified in the Energy Agreement) to integrate approximately 1,100 MW from a variety of renewable energy sources, including solar, biomass, wind, ocean thermal energy conversion, wave, and others. This includes HECO's commitment to integrate, with the assistance of the State of Hawaii, up to 400 MW of wind power into the Oahu electrical grid that would be imported via a yet-to-be-built undersea transmission cable system from wind farms proposed by developers to be built on the islands of Lanai and/or Molokai. Utilizing technical resources such as the U.S. Department of Energy national laboratories, HECO, along with the other parties, have committed to work together to evaluate, assess and address the operational challenges for integrating such a large increment of wind into its grid system on Oahu. The State and HECO have agreed to work together to ensure the supporting infrastructure needed for the Oahu grid is in place to reliably accommodate this large increment of wind power, including appropriate additional storage capacity investments and any required utility system connections or interfaces with the cable and the wind farm facilities.

With respect to the undersea transmission cable system, the State has agreed to seek, with HECO and/or developers' reasonable assistance, federal grant or loan assistance to pay for the undersea cable system. In the event federal funding is unavailable, the State will employ its best effort to fund the undersea cable system through a prudent combination of taxpayer and ratepayer sources. There is no obligation on the part of HECO to fund any of the cost of the undersea cable. However, in the event HECO funds any part of the cost to develop the undersea cable system and assumes any ownership of the cable system, all reasonably incurred capital costs and expenses are intended to be recoverable through the CEIS.

As another method of accelerating the acquisition of renewable energy by the utilities, the Energy Agreement includes support of the parties for the development of a feed-in tariff (FIT) system with standardized purchase prices for renewable energy. The PUC is requested to conclude an investigative proceeding by March 2009 to determine the best design for FIT that support the HCEI goals, considering such factors as categories of renewables, size or locational limits for projects qualifying for the FIT, what annual limits should apply to the amount of renewables allowed to utilize the FIT, what factors to incorporate into the prices set for FIT payments, and other terms and conditions. Based on these understandings, the Energy Agreement requires that the parties request the PUC to suspend the pending intra-governmental wheeling and avoided cost (Schedule Q) dockets for a period of 12 months. On October 24, 2008, the PUC opened an investigative proceeding to examine the implementation of FITs. The utilities and Consumer Advocate were named as initial parties to the proceeding and almost twenty other parties were granted intervention. The procedural schedule for the proceeding includes final position statements by the parties at the end of March 2009, and panel hearings during the week of April 13, 2009. On December 11, 2008, the PUC issued a scoping paper prepared by its consultant that specified certain issues and questions for the parties to address and for the utilities and the Consumer Advocate to consider in a joint FIT proposal. On December 23, 2008, the utilities and the Consumer Advocate filed a joint proposal on FITs that called for the establishment of simple, streamlined and broad standard payment rates, which can be offered to as many renewable technologies as feasible. It proposed that the initial FIT be focused on photovoltaics (PV), concentrated solar power (CSP), in-line hydropower and wind, with individual project sizes targeted to provide a greater likelihood of more straightforward interconnection, project implementation and use of standardized energy rates and power purchase contracting. The FIT would be regularly reviewed to update tariff pricing to applicable technologies, project sizes and annual targets. An FIT update would be conducted for all islands in the utilities' service territory not later than two years after initial implementation of the FIT and every three years thereafter. The proposed initial target project sizes are:

- PV systems up to and including 500 kilowatts (kW) on Oahu, PV systems up to and including 250 kW on Maui and the island of Hawaii and PV systems up to and including 100 kW on Lanai and Molokai.
- CSP systems up to and including 500 kW on Oahu, Maui, and the island of Hawaii and up to and including 100 kW on Lanai and Molokai.
- In-line hydropower systems up to and including 100 kW on Oahu, Maui, Lanai, Molokai and the island of Hawaii.
- Wind power systems up to and including 100 kW on Oahu, Maui, Lanai, Molokai and the island of Hawaii.

The FIT joint proposal also recommended that no applications for new net energy metering contracts be accepted once the FIT is formally made available to customers (although existing net energy metering systems under contract would be grandfathered), and no applications for new Schedule Q contracts would be accepted once an FIT is formally made available for the resource type. Schedule Q would continue as an option for qualifying projects of 100 kW and less for which an FIT is not available.

The Energy Agreement also provides that system-wide caps on net energy metering should be removed. Instead, all distributed generation interconnections, including net metered systems, should be limited on a per-circuit basis to no more than 15% of peak circuit demand, to encourage the development of more cost effective distributed resources while still maintaining safe reliable service.

*The Energy Agreement includes support of the parties for the development and use of renewable biofuels for* electricity generation, including the testing of the technical feasibility of using biofuel or biofuel blends in HECO, HELCO and MECO generating units. The parties agree that use of biofuels in the utilities' generating units, particularly biofuels from local sources, can contribute to achieving RPS requirements and decreasing greenhouse gas emissions, while avoiding major capital investment for new, replacement generation.

In recognition of the need to recover the infrastructure and other investments required to support significantly increased levels of renewable energy and to eliminate the potential conflict between encouraging energy efficiency and conservation and lower sales revenues, the parties agree that it is appropriate to adopt a regulatory rate-making model, which is subject to PUC approval, under which HECO, HELCO and MECO revenues would be decoupled from KWH sales. If approved by the PUC, the new regulatory model, which is similar to the regulatory models currently used in California, would employ a revenue adjustment mechanism to track on an ongoing basis the differences between the amount of revenues allowed in the last rate case and (a) the current costs of providing electric service and (b) a reasonable return on and return of additional capital investment in the electric system. On October 24, 2008, the PUC opened an investigative proceeding to examine implementing a decoupling mechanism for the utilities. In addition to the utilities and the Consumer Advocate, there are six other parties in the proceeding. The utilities and the Consumer

Advocate submitted separate proposals for consideration by the parties in January 2009. The schedule for the proceeding includes technical workshops on the proposals, final position statements of the parties to be submitted in May 2009, and panel hearings during the week of June 29, 2009

The utilities would also continue to use existing PUC-approved tracking mechanisms for pension and other post-retirement benefits. The utilities would also be allowed an automatic revenue adjustment mechanism to reflect changes in state or federal tax rates. The PUC will be requested to incorporate implementation of the new regulatory model in the PUC's future interim decision and order (D&O) in HECO's 2009 test year rate case. The Energy Agreement also contemplates that additional rate cases based on a 2009 test year will be filed by HELCO and MECO in order to provide their respective baselines for implementation of the new regulatory model.

The Energy Agreement confirms that the existing ECAC will continue, subject to periodic review by the PUC. As part of that review, the parties agree that the PUC will examine whether there are renewable energy projects from which the utilities should have, but did not, purchase energy or whether alternate fuel purchase strategies were appropriately used or not used.

With PUC approval, a separate surcharge would be established to allow HECO and its subsidiaries to pass through all reasonably incurred purchased power costs, including all capacity, operation and maintenance expenses and other non-energy payments approved by the PUC which are currently recovered through base rates, with the surcharge to be adjusted monthly and reconciled quarterly.

The Energy Agreement includes a number of other undertakings intended to accomplish the purposes and goals of the HCEI, subject to PUC approval and including, but not limited to: (a) promoting through specifically proposed steps greater use of solar energy through solar water heating, commercial and residential photovoltaic energy installations and concentrated solar power generation; (b) providing for the retirement or placement on reserve standby status of older and less efficient fossil fuel fired generating units as new, renewable generation is installed; (c) improving and expanding "load management" and "demand response" programs that allow the utilities to control customer loads to improve grid reliability and cost management; (d) the filing of PUC applications this year for approval of the installation of Advanced Metering Infrastructure, coupled with time-of-use or dynamic rate options for customers; (e) supporting prudent and cost effective investments in smart grid technologies, which become even more important as wind and solar generation is added to the grid; (f) including 10% of the energy purchased under FITs in each utility's respective rate base through January 2015; and (g) delinking prices paid under all new renewable energy contracts from oil prices.

**Interim increases.** On April 4, 2007, the PUC issued an interim D&O in HELCO's 2006 test year rate case granting a general rate increase on the island of Hawaii of 7.58%, or $25 million, which was implemented on April 5, 2007.

On October 22, 2007, the PUC issued, and HECO immediately implemented, an interim D&O in HECO's 2007 test year rate case, granting HECO an increase of $70 million in annual revenues, a 4.96% increase over rates effective at the time of the interim decision ($78 million in annual revenues over rates granted in the final decision in HECO's 2005 test year rate case).

On December 21, 2007, the PUC issued, and MECO immediately implemented, an interim D&O in MECO's 2007 test year rate case, granting MECO an increase of $13 million in annual revenues, or a 3.7% increase.

As of December 31, 2008, HECO and its subsidiaries had recognized $145 million of revenues with respect to interim orders ($5 million related to interim orders regarding certain integrated resource planning costs and $140 million related to interim orders regarding general rate increase requests). Revenue amounts recorded pursuant to interim orders are subject to refund, with interest, pending a final order.

**Energy cost adjustment clauses.** Hawaii Act 162 was signed into law in June 2006 and requires that any automatic fuel rate adjustment clause requested by a public utility in an application filed with the PUC be designed, as determined in the PUC's discretion, to (1) fairly share the risk of fuel cost changes between the utility and its customers, (2) provide the utility with incentive to manage or lower its fuel costs and encourage greater use of renewable energy, (3) allow the utility to mitigate the risk of sudden or frequent fuel cost changes that cannot otherwise reasonably be mitigated through commercially reasonable means, such as through fuel hedging contracts, (4) preserve the utility's financial integrity, and (5) minimize the utility's need to apply for frequent general rate increases for fuel cost changes. While the PUC already had reviewed the automatic fuel adjustment clauses in rate cases, Act 162 requires that these five specific factors be addressed in the record.

In May 2008, the PUC issued a final D&O in HECO's 2005 test year rate case in which the PUC agreed with the parties' stipulation in the proceeding that it would not require the parties in the proceeding to submit a stipulated procedural schedule to address the Act 162 factors in the 2005 test year rate case proceeding, and stated it expected HECO and HELCO to develop information relating to the Act 162 factors for examination during their next rate case proceedings.

In the HELCO 2006 test year rate case, the filed testimony of the Consumer Advocate's consultant concluded that HELCO's ECAC provides a fair sharing of the risks of fuel cost changes between HELCO and its ratepayers in a manner that preserves the financial integrity of HELCO without the need for frequent rate filings. In April and December 2007, the PUC issued interim D&Os in the HELCO 2006 and MECO 2007 test year rate cases that reflected for purposes of the interim order the continuation of their ECACs, consistent with agreements reached between the Consumer Advocate and HELCO and MECO, respectively. The Consumer Advocate and MECO agreed that no further changes are required to MECO's ECAC in order to comply with the requirements of Act 162.

In September 2007, HECO, the Consumer Advocate and the federal Department of Defense (DOD) agreed that the ECAC should continue in its present form for purposes of an interim rate increase in the HECO 2007 test year rate case and stated that they are continuing discussions with respect to the final design of the ECAC to be proposed for approval in the final D&O. In October 2007, the PUC issued an interim D&O, which reflected the continuation of HECO's ECAC for purposes of the interim increase.

Management cannot predict the ultimate effect of the required Act 162 analysis on the continuation of the utilities' existing ECACs, but the Energy Agreement confirms the intent of the parties that the existing ECACs will continue, subject to periodic review by the PUC. As part of that periodic review, the parties agree that the PUC will examine whether there are renewable energy projects from which the utility should have, but did not, purchase energy or whether alternate fuel purchase strategies were appropriately used or not used.

In December 2008, HECO filed updates to its 2009 test year rate case. The updates proposed the establishment of a purchased power adjustment clause to recover non-energy purchased power costs, pursuant to the Energy Agreement provision stating the utilities "will be allowed to pass through reasonably incurred purchase power contract costs, including all capacity, operation and maintenance (O&M) and other non-energy payments" approved by the PUC through a separate surcharge. The purchased power adjustment clause will be adjusted monthly and reconciled quarterly.

On December 30, 2008, HECO and the Consumer Advocate filed joint proposed findings of fact and conclusions of law in the HECO 2007 test year rate case, which stated that, given the Energy Agreement, which documents a course of action to make Hawaii energy independent and recognizes the need to maintain HECO's financial health while achieving that objective, as well as the overwhelming support in the record for maintaining the ECAC in its current form, the PUC should determine that HECO's proposed ECAC complies with the requirements of Act 162.

**Major projects.** Many public utility projects require PUC approval and various permits from other governmental agencies. Difficulties in obtaining, or the inability to obtain, the necessary approvals or permits can result in significantly increased project costs or even cancellation of projects. Further, completion of projects is subject to various risks, such as problems or disputes with vendors. In the event a project does not proceed, or if the PUC disallows cost recovery for all or part of the project, project costs may need to be written off in amounts that could result in significant reductions in HECO's consolidated net income. Significant projects (with capitalized and deferred costs accumulated through December 31, 2008 noted in parentheses) include generating unit in and transmission line to Campbell Industrial Park ($96 million), HECO's East Oahu Transmission Project ($38 million), HELCO's ST-7 ($55 million) and a Customer Information system ($20 million).

*Campbell Industrial Park (CIP) generating unit.* HECO is building a new 110 MW simple-cycle combustion turbine (CT) generating unit at CIP and plans to add an additional 138 kilovolt transmission line to transmit power from generating units at CIP (including the new unit) to the rest of the Oahu electric grid (collectively, the Project). Plans are for the CT to be run primarily as a "peaking" unit beginning in mid-2009, fueled by biodiesel. On December 15, 2005, HECO signed a contract with Siemens to purchase a 110 MW CT unit.

HECO's Final Environmental Impact Statement for the Project was accepted by the Department of Planning & Permitting of the City and County of Honolulu in August 2006. In December 2006, HECO filed with the PUC an agreement with the Consumer Advocate in which HECO committed to use 100% biofuels in its new plant and to take the steps necessary for HECO to reach that goal. In May 2007, the PUC issued a D&O approving the Project and the Hawaii Department of Health (DOH) issued the final air permit, which became effective at the end of June 2007. The D&O further stated that no part of the Project costs may be included in HECO's rate base unless and until the Project is in fact installed, and is used and useful for public utility purposes. HECO's 2009 test year rate case application, filed in July 2008, requests inclusion of the Project investment in rate base when the new unit is placed in service (expected to be at the end of July 2009). Construction on the Project began in May 2008.

In a related application filed with the PUC in June 2005, HECO requested approval of community benefit measures to mitigate the impact of the new generating unit on communities near the proposed generating unit site. In June 2007, the PUC issued a D&O which (1) approved HECO's request to commit funds for HECO's project to use recycled instead of potable water for industrial water consumption at the Kahe power plant, (2) approved HECO's request to commit funds for the environmental monitoring programs and (3) denied HECO's request to provide a base electric rate discount for HECO's residential customers who live near the proposed generation site. The approved measures are estimated to cost $9 million (through the first 10 years of implementation).

As of December 31, 2008, HECO's cost estimate for the Project (exclusive of the costs of the community benefit measures described above) was $186 million (of which $96 million had been incurred, including $4 million of AFUDC) and outstanding commitments for materials, equipment and outside services totaled $43 million. Management believes no adjustment to project costs is required as of December 31, 2008. However, if it becomes probable that the PUC will disallow some or all of the incurred costs for rate-making purposes, HECO may be required to write off a material portion or all of the project costs incurred in its efforts to put the project into service whether or not it is completed.

In August 2007, HECO entered into a contract with Imperium Services, LLC (Imperium), to supply biodiesel for the planned generating unit, subject to PUC approval. Imperium agreed to comply with HECO's procurement policy requiring sustainable sources of biofuel and biofuel feedstocks. In October 2007, HECO filed an application with the PUC for approval of this biodiesel supply contract. An evidentiary hearing on the application was held in October 2008. Due to deteriorating market conditions in the biodiesel industry, Imperium requested that HECO enter into negotiations to amend the original contract terms in order for Imperium to supply the biodiesel. In January 2009, HECO filed an amended biofuel supply contract with the PUC. In February 2009, HECO filed with the PUC a related terminalling and trucking agreement with Aloha Petroleum, Ltd. to support the delivery and storage of biodiesel from Imperium. In February 2009, the PUC approved modifications to the procedural schedule for this proceeding, calling for a re-opening of the evidentiary hearing in March 2009.

*East Oahu Transmission Project (EOTP).* HECO had planned a project (EOTP) to construct a part underground 138 kilovolt (kV) line in order to close the gap between the southern and northern transmission corridors on Oahu and provide a third transmission line to a major substation. However, in 2002, an application for a permit, which would have allowed construction in a route through conservation district lands, was denied.

HECO continued to believe that the proposed reliability project was needed and, in 2003, filed an application with the PUC requesting approval to commit funds (then estimated at $56 million; see costs incurred below) for an EOTP, revised to use a 46 kV system and modified route, none of which is in conservation district lands. The environmental review process for the EOTP, as revised, was completed in 2005.

In written testimony filed in 2005, a consultant for the Consumer Advocate contended that HECO should always have planned for a project using only the 46 kV system and recommended that HECO be required to expense the $12 million incurred prior to the denial of the permit in 2002, and the related allowance for funds used during construction (AFUDC) of $5 million at the time. HECO contested the consultant's recommendation, emphasizing that the originally proposed 138 kV line would have been a more comprehensive and robust solution to the transmission concerns the project addresses. In October 2007, the PUC issued a final D&O approving HECO's request to expend funds for the EOTP, but stating that the issue of recovery of the EOTP costs would be determined in a subsequent rate case, after the project is installed and in service.

The project is currently estimated to cost $74 million and HECO plans to construct the EOTP in two phases. The first phase is currently in construction and projected to be completed in 2010. The projected completion date of the second phase is being evaluated.

As of December 31, 2008, the accumulated costs recorded for the EOTP amounted to $38 million, including (i) $12 million of planning and permitting costs incurred prior to 2003, (ii) $8 million of planning, permitting and construction costs incurred after 2002 and (iii) $18 million for AFUDC. Management believes no adjustment to project costs is required as of December 31, 2008. However, if it becomes probable that the PUC will disallow some or all of the incurred costs for rate-making purposes, HECO may be required to write off a material portion or all of the project costs incurred in its efforts to put the project into service whether or not it is completed.

*HELCO generating units.* In 1991, HELCO began planning to meet increased demand for electricity forecast for 1994. HELCO planned to install at its Keahole power plant two 20 MW combustion turbines (CT-4 and CT-5), followed by an 18 MW heat recovery steam generator (ST-7), at which time the units would be converted to a 56 MW (net) dual-train combined-cycle unit. In January 1994, the PUC approved expenditures for CT-4. In 1995, the PUC allowed HELCO to pursue construction of and commit expenditures for CT-5 and ST-7, but noted that such costs are not to be included in rate base until the project is installed and "is used and useful for utility purposes."

There were a number of environmental and other permitting challenges to construction of the units, including several lawsuits, which resulted in significant delays. However, in 2003, all but one of the parties actively opposing the plant expansion project entered into a settlement agreement with HELCO and several Hawaii regulatory agencies (the Settlement Agreement) intended in part to permit HELCO to complete CT-4 and CT-5. The Settlement Agreement required HELCO to undertake a number of actions, which have been completed or are ongoing. As a result of the final resolution of various proceedings due primarily to the Settlement Agreement, there are no pending lawsuits involving the project.

CT-4 and CT-5 became operational in mid-2004 and currently can be operated as required to meet its system needs, but additional noise mitigation work is ongoing to ensure compliance with the applicable night-time noise standard.

HELCO has completed engineering and design activities and construction work for ST-7 is progressing towards completion in mid-2009. As of December 31, 2008, HELCO's cost estimate for ST-7 was $92 million (of which $55 million had been incurred) and outstanding commitments for materials, equipment and outside services totaled $28 million, a substantial portion of which are subject to cancellation charges.

*CT-4 and CT-5 costs incurred and allowed.* HELCO's capitalized costs for CT-4 and CT-5 and related supporting infrastructure amounted to $110 million. HELCO sought recovery of these costs as part of its 2006 test year rate case.

In March 2007, HELCO and the Consumer Advocate reached a settlement of the issues in the 2006 rate case proceeding, subject to PUC approval. Under the settlement, HELCO agreed to write-off approximately $12 million of the costs relating to CT-4 and CT-5, resulting in an after-tax charge to net income in the first quarter of 2007 of $7 million (included in "Other, net" under "Other income (loss)" on HECO's consolidated statement of income).

In April 2007, the PUC issued an interim D&O granting HELCO a 7.58% increase in rates, which D&O reflected the agreement to write-off $12 million of the CT-4 and CT-5 costs. However, the interim D&O does not commit the PUC to accept any of the amounts in the interim increase in its final D&O.

If it becomes probable that the PUC will disallow for rate-making purposes additional CT-4 and CT-5 costs in its final D&O or disallow any ST-7 costs, HELCO will be required to record an additional write-off.

*HCEI Projects.* While much of the renewable energy infrastructure contemplated by the Energy Agreement will be developed by others (e.g., wind plant developments on Molokai and Lanai producing in aggregate up to 400 MW of wind power would be owned by a third-party developer, and the undersea cable system to bring the power generated by the wind plants to Oahu is currently planned to be owned by the State), the utilities may be making substantial investments in related infrastructure.

In the Energy Agreement, the State agrees to support, facilitate and help expedite renewable projects, including expediting permitting processes.

**Environmental regulation.** HECO and its subsidiaries are subject to environmental laws and regulations that regulate the operation of existing facilities, the construction and operation of new facilities and the proper cleanup and disposal of hazardous waste and toxic substances.

HECO, HELCO and MECO, like other utilities, periodically experience petroleum or other chemical releases into the environment associated with current operations and report and take action on these releases when and as required by applicable law and regulations. Except as otherwise disclosed herein, the Company believes the costs of responding to releases identified to date will not have a material adverse effect, individually or in the aggregate, on its financial statements.

Additionally, current environmental laws may require HECO and its subsidiaries to investigate whether releases from historical operations may have contributed to environmental impacts, and, where appropriate, respond to such releases, even if they were not inconsistent with law or standard industrial practices prevailing at the time when they occurred. Such releases may involve area-wide impacts contributed to by multiple potentially responsible parties.

*Honolulu Harbor investigation.* HECO has been involved since 1995 in a work group with several other potentially responsible parties (PRPs) identified by the DOH, including oil companies, in investigating and responding to historical subsurface petroleum contamination in the Honolulu Harbor area. The U.S. Environmental Protection Agency (EPA) became involved in the investigation in June 2000. Some of the PRPs (the Participating Parties) entered into a joint defense agreement and ultimately entered an Enforceable Agreement with the DOH. The Participating Parties are funding the investigative and remediation work using an interim cost allocation method (subject to a final allocation) and have organized a limited liability company to perform the work. Although the Honolulu Harbor investigation involves four units—Iwilei, Downtown, Kapalama and Sand Island, to date all the investigative and remedial work has focused on the Iwilei Unit.

Besides subsurface investigation, assessments and preliminary oil removal tasks that have been conducted by the Participating Parties, HECO and others investigated their ongoing operations in the Iwilei Unit in 2003 to evaluate whether their facilities were active sources of petroleum contamination in the area. HECO's investigation concluded that its facilities were not then releasing petroleum. Routine maintenance and inspections of HECO facilities since then confirm that they are not currently releasing petroleum.

For administrative management purposes, the Iwilei Unit has been subdivided into four subunits. The Participating Parties have developed analyses of various remedial alternatives for the four subunits. The DOH uses the analyses to make a final determination of which remedial alternatives the Participating Parties will be required to implement. Once the DOH makes a remedial determination, the Participating Parties are required to develop remedial designs for the various elements of the remedy chosen. The DOH has completed remedial determinations for two subunits to date and the Participating Parties have initiated the remedial design work for those subunits. The Participating Parties anticipate that the DOH will complete the remaining remedial determinations during 2009 and anticipate that all remedial design work will be completed by the end of 2009 or early 2010. The Participating Parties will begin implementation of the remedial design elements as they are approved by the DOH.

Through December 31, 2008, HECO has accrued a total of $3.3 million (including $0.4 million in the first quarter of 2008) for estimates of HECO's share of costs for continuing investigative work, remedial activities and monitoring for the Iwilei unit. As of December 31, 2008, the remaining accrual (amounts expensed less amounts expended) for the Iwilei unit was $1.8 million. Because (1) the full scope of work remains to be determined, (2) the final cost allocation method among the PRPs has not yet been established and (3) management cannot estimate the costs to be incurred (if any) for the sites other than the Iwilei unit (such as its Honolulu power plant located in the Downtown unit of the Honolulu Harbor site), the cost estimate may be subject to significant change and additional material costs may be incurred.

*Regional Haze Rule amendments.* In June 2005, the EPA finalized amendments to the July 1999 Regional Haze Rule that require emission controls known as best available retrofit technology (BART) for industrial facilities emitting air pollutants that reduce visibility in National Parks by causing or contributing to regional haze. States were to adopt BART implementation plans and schedules in accordance with the amended regional haze rule by December 2007. After Hawaii adopts its plan, which it has not done to date, HECO, HELCO and MECO will evaluate the plan's impacts, if any. If any of the utilities' generating units are ultimately required to install post-combustion control technologies to meet BART emission limits, the resulting capital and operation and maintenance costs could be significant.

*Hazardous Air Pollutant (HAP) Control*. In February 2008, the federal Circuit Court of Appeals for the District of Columbia vacated the EPA's Delisting Rule, which had removed coal- and oil-fired electric generating units (EGUs) from the list of sources requiring control under Section 112 of the Clean Air Act. The EPA's request for a rehearing was denied. The EPA is thus required to develop Maximum Achievable Control Technology (MACT) standards for oil-fired EGU HAP emissions, including nickel compounds. Depending on the MACT standards developed (and the success of a potential challenge, after the MACT standards are issued, that the EPA inappropriately listed oil-fired EGUs initially), costs to comply with the standards could be significant. The Company is currently evaluating its options regarding potential MACT standards for applicable HECO steam units.

In October 2008, the EPA petitioned the U.S. Supreme Court to review the decision of the Circuit Court of Appeals for the District of Columbia vacating the EPA's Delisting Rule. Also, an industry group is seeking review of the Delisting Rule decision. On February 6, 2009, the EPA filed a motion with the Supreme Court to withdraw its petition for review. In the motion, the EPA indicated that it would begin rulemaking to establish MACT standards for EGUs. Management cannot predict if the Supreme Court will grant the industry petitioners' request for review and is evaluating options available regarding the rulemaking if the Supreme Court rejects industry petitioners' request for review or upholds the Court of Appeals decision.

*Clean Water Act*. Section 316(b) of the federal Clean Water Act requires that the EPA ensure that existing power plant cooling water intake structures reflect the best technology available for minimizing adverse environmental impacts. In 2004, the EPA issued a rule establishing design, construction and capacity standards for existing cooling water intake structures, such as those at HECO's Kahe, Waiau and Honolulu generating stations, and required demonstrated compliance by March 2008. The rule provided a number of compliance options, some of which were far less costly than others. HECO had retained a consultant that was developing a cost effective compliance strategy.

In January 2007, the U.S. Circuit Court of Appeals for the Second Circuit issued a decision that remanded for further consideration and proceedings significant portions of the rule and found other portions to be impermissible. In July 2007, the EPA formally suspended the rule and provided guidance to federal and state permit writers that they should use their "best professional judgment" in determining permit conditions regarding cooling water intake requirements at existing power plants. HECO facilities are subject to permit renewal in mid-2009 and may be subject to new permit conditions to address cooling water intake requirements at that time. In April 2008, the U.S. Supreme Court agreed to review the Court of Appeal's rejection of a cost-benefit test to determine compliance options. The Supreme Court heard the case in December 2008 and a decision is anticipated in the first half of 2009. If the Supreme Court affirms the Court of Appeal's decision, the compliance options available to HECO are reduced. Due to the uncertainties regarding the Court of Appeal's decision, management is unable to predict which compliance options, some of which could entail significant capital expenditures to implement, will be applicable to its facilities.

**Collective bargaining agreements.** As of December 31, 2008, approximately 57% of the Company's employees were members of the International Brotherhood of Electrical Workers, AFL-CIO, Local 1260, Unit 8, which is the only union representing employees of the Company. On March 1, 2008, members of the union ratified new collective bargaining and benefit agreements with HECO, HELCO and MECO. The new agreements cover a three-year term, from November 1, 2007 to October 31, 2010, and provide for non-compounded wage increases of 3.5% effective November 1, 2007, 4% effective January 1, 2009 and 4.5% effective January 1, 2010.

**Limited insurance.** HECO and its subsidiaries purchase insurance to protect themselves against loss or damage to their properties against claims made by third-parties and employees. However, the protection provided by such insurance is limited in significant respects and, in some instances, there is no coverage. HECO, HELCO and MECO's overhead and underground transmission and distribution systems (with the exception of substation buildings and contents) have a replacement value roughly estimated at $4 billion and are uninsured. Similarly, HECO, HELCO and MECO have no business interruption insurance. If a hurricane or other uninsured catastrophic natural disaster were to occur, and if the PUC were not to allow the utilities to recover from ratepayers restoration costs and revenues lost from business interruption, their results of operations and financial condition could be materially adversely impacted. Also, certain insurance has substantial "deductibles", limits on the maximum amounts that may be recovered and exclusions or limitations of coverage for claims related to certain perils. If a series of losses occurred, such as from a series of lawsuits in the ordinary course of business, each of which were subject to the deductible amount, or if the maximum limit of the available insurance were substantially exceeded, HECO, HELCO and MECO could incur losses in amounts that would have a material adverse effect on its results of operations and financial condition.

## 12. Regulatory restrictions on distributions to parent

As of December 31, 2008, net assets (assets less liabilities and preferred stock) of approximately $506 million were not available for transfer to HEI in the form of dividends, loans or advances without regulatory approval.

## 13. Related-party transactions

HEI charged HECO and its subsidiaries $4.7 million, $3.4 million and $3.4 million for general management and administrative services in 2008, 2007 and 2006, respectively. The amounts charged by HEI to its subsidiaries are allocated primarily on the basis of actual labor hours expended in providing such services.

HECO's short-term borrowings from HEI fluctuate during the year, and totaled $41.6 million and nil at December 31, 2008 and 2007, respectively. The interest charged on short-term borrowings from HEI is based on the lower of HEI's or HECO's effective weighted average short-term external borrowing rate. If both HEI and HECO do not have short-term external borrowings, the interest is based on the average of the effective rate for 30-day dealer-placed commercial paper quoted by the Watt Street Journal.

Borrowings among HECO and its subsidiaries are eliminated in consolidation. Interest charged by HEI to HECO was de minimis in 2008, 2007 and 2006.

## 14. Significant group concentrations of credit risk

HECO and its utility subsidiaries are regulated operating electric public utilities engaged in the generation, purchase, transmission, distribution and sale of electricity on the islands of Oahu, Hawaii, Maui, Lanai and Molokai in the State of Hawaii. HECO and its utility subsidiaries provide the only electric public utility service on the islands they serve. HECO and its utility subsidiaries grant credit to customers, all of whom reside or conduct business in the State of Hawaii.

## 15. Fair value of financial instruments

Fair value estimates are based on the price that would be received to sell an asset, or paid upon the transfer of a liability, in an orderly transaction between market participants at the measurement date. The fair value estimates are generally determined based on assumptions that market participants would use in pricing the asset or liability and are based on market data obtained from independent sources. However, in certain cases, the Company uses its own assumptions about market participant assumptions based on the best information available in the circumstances. These valuations are estimates at a specific point in time, based on relevant market information, information about the financial instrument and judgments regarding future expected loss experience, economic conditions, risk characteristics of various financial instruments and other factors. These estimates do not reflect any premium or discount that could result if the Company were to sell its entire holdings of a particular financial instrument at one time. Because no market exists for a portion of the Company's financial instruments, fair value estimates cannot be determined with precision. Changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the estimates. Fair value estimates are provided for certain financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. In addition, the tax ramifications related to the realization of the unrealized gains and losses could have a significant effect on fair value estimates and have not been considered.

The Company used the following methods and assumptions to estimate the fair value of each applicable class of financial instruments for which it is practicable to estimate that value:

**Cash and equivalents and short-term borrowings**

The carrying amount approximated fair value because of the short maturity of these instruments.

**Long-term debt**

Fair value was obtained from a third-party financial services provider based on the current rates offered for debt of the same or similar remaining maturities.

**Off-balance sheet financial instruments**

Fair value of HECO-obligated preferred securities of trust subsidiaries was based on quoted market prices.

The estimated fair values of the financial instruments held or issued by the Company were as follows:

| December 31<br>(in thousands) | 2008<br>Carrying Amount | 2008<br>Estimated fair value | 2007<br>Carrying amount | 2007<br>Estimated fair value |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Cash and equivalents | $ 6,901 | $ 6,901 | $ 4,678 | $ 4,678 |
| **Financial liabilities:** | | | | |
| Short-term borrowings from nonaffiliates | -- | -- | 28,791 | 28,791 |
| Long-term debt, net, including amounts due within one year | 904,501 | 660,380 | 885,099 | 904,092 |
| **Off-balance sheet item:** | | | | |
| HECO-obligated preferred securities of trust subsidiary | 50,000 | 40,420 | 50,000 | 46,200 |

## 16. Sale of non-electric utility property

In August 2007, HECO sold land and a building that executives and management had been using as a recreational facility. The sale of the non-electric utility property resulted in an after-tax gain in the third quarter of 2007 of approximately $2.9 million.

## 17. Consolidated quarterly financial information *(unaudited)*

Selected quarterly consolidated financial information of the Company for 2008 and 2007 follows:

| 2008<br>(in thousands) | Quarters ended<br>March 31 | June 30 | Sept. 30 | Dec. 31 | Year ended<br>Dec. 31 |
|---|---|---|---|---|---|
| Operating revenues (1) | $622,494 | $686,647 | $826,124 | $718,374 | $2,853,639 |
| Operating income (1) | 34,666 | 37,388 | 35,414 | 22,469 | 129,937 |
| Net income for common stock (1) | 24,585 | 27,432 | 25,932 | 14,026 | 91,975 |

| 2007<br>(in thousands) | Quarters ended<br>March 31 | June 30 | Sept. 30 | Dec. 31 | Year ended<br>Dec. 31 |
|---|---|---|---|---|---|
| Operating revenues (2),(3) | $446,797 | $491,249 | $561,720 | $597,192 | $2,096,958 |
| Operating income (2),(3) | 19,503 | 21,222 | 20,736 | 38,814 | 100,275 |
| Net income for common stock (2),(3),(4) | 453 | 10,650 | 12,875 | 28,178 | 52,156 |

Note: HEI owns all of HECO's common stock, therefore per share data is not meaningful.

(1) For 2008, amounts include interim rate relief for HECO (2007 test year), HELCO (2006 test year) and MECO (2007 test year). The fourth quarter of 2008 includes a reduction of $1.3 million, net of taxes, of revenues related to prior periods.

(2) For 2007, amounts include interim rate relief for HECO (2005 test year; 2007 test year since October 22, 2007), HELCO (2006 test year since April 5, 2007) and MECO (2007 test year since December 21, 2007).

(3) The third quarter of 2007 includes a $9 million, net of tax benefits, reserve accrued for the potential refund (with interest) of a portion of HECO's 2005 test year interim rate increase.

(4) The first quarter of 2007 includes a $7 million, net of tax benefits, write-off of plant in service costs at HELCO as part of a settlement in HELCO's 2006 test year rate case.

## Explanation of Reclassifications and Eliminations on Consolidating Schedules

**Hawaiian Electric Company, Inc. and Subsidiaries as of and for the year ended December 31, 2008**

[1] Eliminations of intercompany receivables and payables and other intercompany transactions.

[2] Elimination of investment in subsidiaries, carried at equity.

[3] Reclassification of preferred stock dividends of Hawaii Electric Light Company, Inc. and Maui Electric Company, Limited and of accrued income taxes for financial statement presentation.

## Consolidating Schedule – Income (Loss) Information

**Hawaiian Electric Company, Inc. and Subsidiaries**

| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Reclassifications and Eliminations | HECO Consolidated |
|---|---|---|---|---|---|---|---|
| | Year ended December 31, 2008 | | | | | | |
| Operating revenues | $1,954,772 | 446,297 | 452,570 | -- | -- | -- | $2,853,639 |
| **Operating expenses** | | | | | | | |
| Fuel oil | 866,827 | 109,617 | 252,749 | -- | -- | -- | 1,229,193 |
| Purchased power | 475,205 | 176,248 | 38,375 | -- | -- | -- | 689,828 |
| Other operation | 172,663 | 33,027 | 37,559 | -- | -- | -- | 243,249 |
| Maintenance | 68,670 | 16,796 | 16,158 | -- | -- | -- | 101,624 |
| Depreciation | 82,208 | 31,279 | 28,191 | -- | -- | -- | 141,678 |
| Taxes, other than income taxes | 179,418 | 40,811 | 41,594 | -- | -- | -- | 261,823 |
| Income taxes | 33,330 | 12,097 | 10,880 | -- | -- | -- | 56,307 |
| | 1,878,321 | 419,875 | 425,506 | -- | -- | -- | 2,723,702 |
| **Operating income** | 76,451 | 26,422 | 27,064 | -- | -- | -- | 129,937 |
| **Other income** | | | | | | | |
| Allowance for equity funds used during construction | 7,088 | 1,737 | 565 | -- | -- | -- | 9,390 |
| Equity in earnings of subsidiaries | 37,009 | -- | -- | -- | -- | (37,009) [2] | -- |
| Other, net | 6,134 | 1,562 | 305 | (77) | (347) | (1,918) [1] | 5,659 |
| | 50,231 | 3,299 | 870 | (77) | (347) | (38,927) | 15,049 |
| **Income before interest and other charges** | 126,682 | 29,721 | 27,934 | (77) | (347) | (38,927) | 144,986 |
| ***Interest and other charges*** | | | | | | | |
| Interest on long-term debt | 30,412 | 7,844 | 9,046 | -- | -- | -- | 47,302 |
| Amortization of net bond premium and expense | 1,606 | 436 | 488 | -- | -- | -- | 2,530 |
| Other interest charges | 4,383 | 2,001 | 459 | -- | -- | (1,918) [1] | 4,925 |
| Allowance for borrowed funds used during construction | (2,774) | (735) | (232) | -- | -- | -- | (3,741) |
| Preferred stock dividends of subsidiaries | -- | -- | -- | -- | -- | 915 [3] | 915 |
| | 33,627 | 9,546 | 9,761 | -- | -- | (1,003) | 51,931 |
| **Income before preferred stock dividends of HECO** | 93,055 | 20,175 | 18,173 | (77) | (347) | (37,924) | 93,055 |
| Preferred stock dividends of HECO | 1,080 | 534 | 381 | -- | -- | (915) [3] | 1,080 |
| **Net income for common stock** | $ 91,975 | 19,641 | 17,792 | (77) | (347) | (37,009) | $ 91,975 |

## Consolidating Schedule - Retained Earnings Information

**Hawaiian Electric Company, Inc. and Subsidiaries**

| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Reclassifications and Eliminations | HECO Consolidated |
|---|---|---|---|---|---|---|---|
| | Year ended December 31, 2008 | | | | | | |
| Retained earnings, beginning of period | $724,704 | 101,055 | 113,377 | (599) | (47) | (213,786) [2] | $724,704 |
| Net income for common stock | 91,975 | 19,641 | 17,792 | (77) | (347) | (37,009) [2] | 91,975 |
| Common stock dividends | (14,089) | -- | (10,965) | -- | -- | 10,965 [2] | (14,089) |
| Retained earnings, end of period | $802,590 | 120,696 | 120,204 | (676) | (394) | (239,830) | $802,590 |

See accompanying "Report of Independent Registered Public Accounting Firm."

## Consolidating Schedule - Balance Sheet Information

Hawaiian Electric Company, Inc. and Subsidiaries

| | December 31, 2008 | | | | | | |
|---|---|---|---|---|---|---|---|
| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Reclassifications and Eliminations | HECO Consolidated |
| Assets | | | | | | | |
| Utility plant, at cost | | | | | | | |
| Land | $ 33,213 | 4,982 | 4,346 | -- | -- | -- | $ 42,541 |
| Plant and equipment | 2,567,018 | 874,322 | 836,159 | -- | -- | -- | 4,277,499 |
| Less accumulated depreciation | (1,028,501) | (352,382) | (360,570) | -- | -- | -- | (1,741,453) |
| Construction in progress | 188,754 | 68,650 | 9,224 | -- | -- | -- | 266,628 |
| Net utility plant | 1,760,484 | 595,572 | 489,159 | -- | -- | -- | 2,845,215 |
| Investment in wholly owned subsidiaries, at equity | 437,033 | -- | -- | -- | -- | (437,033) [2] | -- |
| Current assets | | | | | | | |
| Cash and equivalents | 2,264 | 3,148 | 1,349 | 123 | 17 | -- | 6,901 |
| Advances to affiliates | 62,000 | -- | 12,000 | -- | -- | (74,000) [1] | -- |
| Customer accounts receivable, net | 109,724 | 32,108 | 24,590 | -- | -- | -- | 166,422 |
| Accrued unbilled revenues, net | 74,657 | 17,876 | 14,011 | -- | -- | -- | 106,544 |
| Other accounts receivable, net | 3,983 | 2,217 | 1,143 | -- | 11 | 564 [1] | 7,918 |
| Fuel oil stock, at average cost | 53,546 | 10,326 | 13,843 | -- | -- | -- | 77,715 |
| Materials & supplies, at average cost | 16,583 | 4,366 | 13,583 | -- | -- | -- | 34,532 |
| Prepayments and other | 6,918 | 2,311 | 3,664 | -- | -- | (267) [3] | 12,626 |
| Total current assets | 329,675 | 72,352 | 84,183 | 123 | 28 | (73,703) | 412,658 |
| Other long-term assets | | | | | | | |
| Regulatory assets | 388,054 | 77,038 | 65,527 | -- | -- | -- | 530,619 |
| Unamortized debt expense | 9,802 | 2,282 | 2,419 | -- | -- | -- | 14,503 |
| Other | 38,099 | 7,699 | 7,197 | -- | 119 | -- | 53,114 |
| Total other long-term assets | 435,955 | 87,019 | 75,143 | -- | 119 | -- | 598,236 |
| | $2,963,147 | 754,943 | 648,485 | 123 | 147 | (510,736) | $3,856,109 |
| Capitalization and liabilities | | | | | | | |
| Capitalization | | | | | | | |
| Common stock equity | $1,188,842 | 221,405 | 215,382 | 105 | 141 | (437,033) [2] | $1,188,842 |
| Cumulative preferred stock–not subject to mandatory redemption | 22,293 | 7,000 | 5,000 | -- | -- | -- | 34,293 |
| Long-term debt, net | 582,132 | 148,030 | 174,339 | -- | -- | -- | 904,501 |
| Total capitalization | 1,793,267 | 376,435 | 394,721 | 105 | 141 | (437,033) | 2,127,636 |
| Current liabilities | | | | | | | |
| Short-term borrowings-affiliate | 53,550 | 62,000 | -- | -- | -- | (74,000) [1] | 41,550 |
| Accounts payable | 84,238 | 27,795 | 10,961 | -- | -- | -- | 122,994 |
| Interest and preferred dividends payable | 10,242 | 2,547 | 2,819 | -- | -- | (211) [1] | 15,397 |
| Taxes accrued | 144,366 | 38,117 | 37,830 | -- | -- | (267) [3] | 220,046 |
| Other | 33,462 | 9,015 | 11,992 | 18 | 6 | 775 [1] | 55,268 |
| Total current liabilities | 325,858 | 139,474 | 63,602 | 18 | 6 | (73,703) | 455,255 |
| Deferred credits and other liabilities | | | | | | | |
| Deferred income taxes | 134,359 | 19,621 | 12,330 | -- | -- | -- | 166,310 |
| Regulatory liabilities | 202,003 | 49,843 | 36,756 | -- | -- | -- | 288,602 |
| Unamortized tax credits | 32,501 | 13,476 | 12,819 | -- | -- | -- | 58,796 |
| Retirement benefits liability | 284,826 | 54,664 | 53,355 | -- | -- | -- | 392,845 |
| Other | 11,576 | 35,432 | 7,941 | -- | -- | -- | 54,949 |
| Total deferred credits and other liabilities | 665,265 | 173,036 | 123,201 | -- | -- | -- | 961,502 |
| Contributions in aid of construction | 178,757 | 65,998 | 66,961 | -- | -- | -- | 311,716 |
| | $2,963,147 | 754,943 | 648,485 | 123 | 147 | (510,736) | $3,856,109 |

See accompanying "Report of Independent Registered Public Accounting Firm."

## Consolidating Schedule - Changes in Common Stock Equity Information

Hawaiian Electric Company, Inc. and Subsidiaries

| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Reclassifications and eliminations | HECO consolidated |
|---|---|---|---|---|---|---|---|
| Balance, December 31, 2007 | 1,110,462 | 201,820 | 208,521 | 182 | 388 | (410,911) | 1,110,462 |
| Comprehensive income: | | | | | | | |
| Net income (loss) | 91,975 | 19,641 | 17,792 | (77) | (347) | (37,009) | 91,975 |
| Retirement benefit plans: | | | | | | | |
| Net losses arising during the period, net of tax benefits of $100,141 | (157,226) | (24,243) | (20,329) | -- | -- | 44,572 | (157,226) |
| Less: amortization of transition obligation, prior service cost and net losses recognized during the period in net periodic benefit cost, net of tax benefits of $3,481 | 5,464 | 760 | 621 | -- | -- | (1,381) | 5,464 |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory asset, net of taxes of $96,975 | 152,256 | 23,427 | 19,742 | -- | -- | (43,169) | 152,256 |
| Comprehensive income (loss) | 92,469 | 19,585 | 17,826 | (77) | (347) | (36,987) | 92,469 |
| Common stock dividends | (14,089) | -- | (10,965) | -- | -- | 10,965 | (14,089) |
| Issuance of common stock | -- | -- | -- | -- | 100 | (100) | -- |
| Balance, December 31, 2008 | $1,188,842 | 221,405 | 215,382 | 105 | 141 | (437,033) | $1,188,842 |

See accompanying "Report of Independent Registered Public Accounting Firm."

## Consolidating Schedule - Cash Flows Information

Hawaiian Electric Company, Inc. and Subsidiaries

| (in thousands) | HECO | HELCO | MECO | RHI | UBC | Elimination addition to (deduction from) cash flows | | HECO Consolidated |
|---|---|---|---|---|---|---|---|---|
| | Year ended December 31, 2008 | | | | | | | |
| **Cash flows from operating activities:** | | | | | | | | |
| Income before preferred stock dividends of HECO | $ 93,055 | 20,175 | 18,173 | (77) | (347) | (37,924) | [2] | $ 93,055 |
| Adjustments to reconcile income before preferred stock dividends of HECO to net cash provided by operating activities: | | | | | | | | |
| Equity in earnings | (37,109) | -- | -- | -- | -- | 37,009 | [2] | (100) |
| Common stock dividends received from subsidiaries | 11,065 | -- | -- | -- | -- | (10,965) | [2] | 100 |
| Depreciation of property, plant and equipment | 82,208 | 31,279 | 28,191 | -- | -- | -- | | 141,678 |
| Other amortization | 3,145 | 743 | 4,731 | -- | -- | -- | | 8,619 |
| Deferred income taxes | 3,457 | 1,866 | (1,441) | -- | -- | -- | | 3,882 |
| Tax credits, net | 555 | 696 | 219 | -- | -- | -- | | 1,470 |
| Allowance for equity funds used during construction | (7,088) | (1,737) | (565) | -- | -- | -- | | (9,390) |
| Changes in assets and liabilities: | | | | | | | | |
| Increase in accounts receivable | (8,921) | (5,290) | (1,279) | -- | (11) | (5,812) | [1] | (21,313) |
| Decrease (increase) in accrued unbilled revenues | 7,893 | (1,081) | 918 | -- | -- | -- | | 7,730 |
| Decrease in fuel oil stock | 3,743 | 2,168 | 8,245 | -- | -- | -- | | 14,156 |
| Decrease (increase) in materials and supplies | (860) | 38 | 548 | -- | -- | -- | | (274) |
| Increase in regulatory assets | (151) | (87) | (2,991) | -- | -- | -- | | (3,229) |
| Increase (decrease) in accounts payable | (13,461) | 5,985 | (7,425) | -- | -- | -- | | (14,901) |
| Changes in prepaid and accrued income and utility revenue taxes | 25,155 | 2,638 | 262 | -- | -- | -- | | 28,055 |
| Changes in other assets and liabilities | (7,551) | (4,089) | 422 | 2 | (41) | 5,812 | [2] | (5,445) |
| Net cash provided by (used in) operating activities | 155,135 | 53,304 | 48,008 | (75) | (399) | (11,880) | | 244,093 |
| **Cash flows from investing activities:** | | | | | | | | |
| Capital expenditures | (162,041) | (84,948) | (31,487) | -- | -- | -- | | (278,476) |
| Contributions in aid of construction | 9,928 | 4,669 | 2,722 | -- | -- | -- | | 17,319 |
| Advances from (to) affiliates | (25,400) | -- | (10,000) | -- | -- | 35,400 | [1] | -- |
| Other | 1,276 | -- | -- | -- | (119) | -- | | 1,157 |
| Investment in consolidated subsidiary | (100) | -- | -- | -- | -- | 100 | [2] | -- |
| Net cash used in investing activities | (176,337) | (80,279) | (38,765) | -- | (119) | 35,500 | | (260,000) |
| **Cash flows from financing activities:** | | | | | | | | |
| Common stock dividends | (14,089) | -- | (10,965) | -- | -- | 10,965 | [2] | (14,089) |
| Preferred stock dividends | (1,080) | (534) | (381) | -- | -- | 915 | [2] | (1,080) |
| Proceeds from issuance of long-term debt | 14,407 | 2,188 | 2,680 | -- | -- | -- | | 19,275 |
| Proceeds from issuance of common stock | -- | -- | -- | -- | 100 | (100) | [2] | -- |
| Net increase in short-term borrowings from nonaffiliates and affiliate with original maturities of three months or less | 22,759 | 25,400 | -- | -- | -- | (35,400) | [1] | 12,759 |
| Other | 1,266 | -- | (1) | -- | -- | -- | | 1,265 |
| Net cash provided by (used in) financing activities | 23,263 | 27,054 | (8,667) | -- | 100 | (23,620) | | 18,130 |
| Net increase (decrease) in cash and equivalents | 2,061 | 79 | 576 | (75) | (418) | -- | | 2,223 |
| Cash and equivalents, beginning of year | 203 | 3,069 | 773 | 198 | 435 | -- | | 4,678 |
| Cash and equivalents, end of year | $ 2,264 | 3,148 | 1,349 | 123 | 17 | -- | | $ 6,901 |

See accompanying "Report of Independent Registered Public Accounting Firm."